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JAMES H. McKENNEY
Clerk

Br. of Turner & Mott for Appellee

Supreme Court of the United States,

OCTOBER TERM, 1898.

Filed Feb. 27, 1899.

NO. 162.

THE LACKAWANNA IRON AND COAL COMPANY,
Intervening Petitioner-Appellant,

vs.

THE FARMERS' LOAN AND TRUST COMPANY,
Complainant-Respondent.

BRIEF FOR THE FARMERS' LOAN AND TRUST COMPANY, RESPONDENT, IN OPPOSITION TO THE INTERVENTION OF THE LACKAWANNA IRON AND COAL COMPANY.

HERBERT B. TURNER,
M. F. MOTT,
Solicitors and of Counsel for THE FARMERS' LOAN AND TRUST COMPANY.

Supreme Court of the United States.

OCTOBER TERM, 1898.

THE LACKAWANNA IRON AND COAL COMPANY, Petitioner, Intervenor-Appellant,

vs.

THE FARMERS' LOAN AND TRUST COMPANY, Complainant-Respondent.

Brief for the Farmers' Loan and Trust Company, Respondent.

Statement.

In 1866, and prior to that time, The Houston and Texas Central Railway Company was a Texas corporation, operating a railroad from the north line of that State to Houston, with a branch from Houston to Austin, and another branch from Bremond to Waco. It made a mortgage covering the main line in 1866, and subsequently other mortgages covering the branch lines respectively, besides several junior mortgages. One of these branches, called the Waco and Northwestern Division, is the subject-matter of the present litigation. On this particular branch the Houston and Texas Central placed two mortgages, a first and a second, each to secure a separate series of bonds. The first is dated

June 16th, 1873. The suit in which the Lackawanna Iron and Coal Company filed its intervention was brought by the Farmers' Loan and Trust Company, as Trustee, to foreclose this first mortgagee.

Several years before this foreclosure was commenced, and in February, 1885, Receivers of the entire property of the Houston and Texas Central Railway Company, including the Waco and Northwestern Division, were appointed by the United States Circuit Court for the Eastern District of Texas, under a creditor's bill, filed by the Southern Development Company, which claimed to be a creditor for moneys loaned, etc. The cause instituted by the Southern Development Company was known as Cause No. 185. A little more than one year after its institution, and in May, 1886, the Court, Mr. Justice Woods of this Court presiding, dismissed the bill of the Southern Development Company, on demurrers filed by James Rintoul and Nelson S. Easton, the main line first mortgage trustees. Thereupon, and on the day of the dismissal of said bill, the trustees of the mortgages on the main line and on the Austin Division filed bills to foreclose those mortgages, and the causes were consolidated under the title of Consolidated Cause No. 198, and James Rintoul, Nelson S. Easton and Charles Dillingham were appointed Receivers under such foreclosure bills.

It must be carefully noted that the trustee of the first mortgage on the Waco and Northwestern Division, which is the mortgage to foreclose which the present suit was brought, did not then file a bill to foreclose that mortgage, the holders of those bonds being under the impression that they were a perfectly good seven per cent. investment, with a very considerable time to run. They discovered their error afterwards.

A decree was had in Consolidated Cause No. 198 for the foreclosure of the mortgages covering the entire property, on May 4th, 1888, and under the provisions of that decree the entire property was sold September 8th, 1888. The sale was made subject to the first mortgage on the Waco and Northwestern Division, which is the subject-matter of this suit. Indeed, the entire proceedings were subject to all rights existing under the Waco and Northwestern first mortgage. That division was sold separately, subject to the first mortgage, and purchased by one George S. Downs.

On September 6th, 1889, and after all this had happened, after the decree had been rendered and the sale had been made and the property had passed into the hands of the reorganized company, which took the same subject to the first mortgage on the Waco and Northwestern Division, the complainant, the trustee under that first mortgage on that division, filed the bill to foreclose the same. This suit became known as Cause No. 227, and a Receiver was appointed therein.

The complainant was first met by dilatory motions, which were not finally decided until October, 1890. Thereupon, the parties who had interposed these dilatory motions, demurred to the bill.

The demurrer was argued December 19th, 1890, and overruled a few days later. Thereupon the defendants interposed an answer, which was filed on the February, 1891, rule day. Testimony was taken, with the usual delays, so that the cause was not brought on for final hearing until March, 1892, when a decree of foreclosure and sale was rendered. The decree contained the following provision respecting the claim of the petitioner, the Lackawanna Company:

"It is further ordered, adjudged and decreed, that the rights of the Lackawanna Coal and Iron

Company * * * intervenors herein, and the rights of all other intervenors herein, be and they are hereby reserved to be hereinafter adjudicated, and are in no manner affected or prejudiced by this decree."

In accordance with this decree the property was sold December 28th, 1892, and struck off to E. H. R. Green for one million three hundred and seventy-five thousand dollars.

Green did not complete his purchase. On the contrary, he took proceedings to be relieved of his bid. These proceedings occupied a great deal of time, and he was finally so relieved in 1894.

The property was thereupon again advertised for sale and sold September 3d, 1895, for $1,505,000.

The intervening petition of the Lackawanna Iron and Coal Company (Transcript of Record, page 75) avers that on the 28th day of December, 1882, the 26th day of April, 1883, and the 30th day of October, 1883, under three certain contracts bearing said dates, the petitioner agreed to furnish to the Houston and Texas Central Railway Company, upon terms and conditions specifically set forth in said contracts, about 20,000 tons of steel rails, at the prices severally mentioned; that it was agreed in said contracts that upon the delivery of each 560 tons of said rails, or thereabouts, payments were to be made to the petitioner therefor in cash, or in notes of the railway company, payable in six months from the average date of delivery to the maturity of the notes, with interest at six per cent., and with the privilege of renewing the notes before their maturity for a further term of six months; that under the first contract of December 28th, 1882, petitioner delivered about 5,020 tons of rail, and received therefor under the contract ten

promissory notes, and that under the second contract of April 26th, 1883, the petitioner delivered about 5,009 tons of rail and received promissory notes, and that under the third contract of October 30th, 1883, petitioner delivered about 8,552 tons and received promissory notes, all of which were extended for six months ; that the first five notes given petitioner under the first contract of December 28th, 1882, were paid at maturity, that the other five notes were partially paid at maturity and partially extended, and that the extended notes were all finally paid in full ; that of the ten notes given under the second contract of April 26th, 1883, some were partially paid at maturity and extended, and the extended notes partially paid and extended further; and that there remains due from the Railway Company to the petitioner for steel rails the sum of $445,175.50, with interest. The petition further states that the rails were used in the betterment of the road and were absolutely necessary, and that the indebtedness was contracted by the petitioner in consideration of the promise of the Railway Company to pay these notes out of its earnings, and that the rails were furnished with the expectation and belief that they would be paid for out of the revenue and earnings ; that the Houston and Texas Central Railway Company was placed in the hands of Receivers on or about February 1, 1885, and that when the bill was filed in this cause, April 6, 1889, to foreclose the first mortgage on the Waco and Northwestern Division, the Receivership was extended to this cause so brought for that foreclosure, and that a considerable portion of the rails was used upon the Waco and Northwestern Division. The petitioner therefore seeks to have the proportionate amount of money due for the sale of these rails paid out of the earnings in the hands of the Receiver, or, if such earn-

ings prove insufficient, then out of the proceeds of sale. But it must be especially noted that, while it appears in the petition that a large amount of the petitioner's debt has been paid, namely, the entire contract price under the first contract, and a large amount of the purchase price under the second contract, nevertheless, the petition contains no allegation to the effect that the rails which were so paid for were not the very rails which were laid on the Waco and Northwestern Division. The petitioner assumes that the Waco and Northwestern Division was relaid with rails which were not paid for, as to which there is absolutely no allegation in the petition. The allegation made in the petition (foot of page 85 of the Record) is that the petitioner is informed and believes and so avers that a large portion of the steel rails *so furnished* by petitioner to said defendant Railway Company was for the use and benefit of and was actually used upon and now constitutes a part of the railway described in the bill of complaint in this cause; but the petitioner nowhere states that those rails so furnished and used upon the railway described in the bill of complaint in this cause were not duly paid for. It is true that the Master reported that a part of the Waco and Northwestern Division was relaid with rails which were paid for, and a part with rails which were not paid for, but the petitioner makes no such allegation.

The petition further alleges that the Southern Development Company brought suit upon a similar claim in the Federal Court in Texas, being Equity Cause No. 185, and that general and special demurrers were filed to the bill, which were sustained by the Court and the bill dismissed without prejudice.

This matter was referred to a Master, who took

testimony and heard argument and finally filed a report, January 13th, 1896 (Record, page 98). In this report (which was not excepted to) the Master finds that negotiable promissory notes were given by the Houston and Texas Central Railway Company for all the rails sold under the three contracts; that all of said sales were made on a stated credit for a fixed period of time, namely, six months after the average date of each delivery, and that the defendant, the Houston and Texas Central Railway Company, had the right under the said contracts to have the time extended six months from the maturity of the notes; that said extensions were made for the accommodation and to suit the convenience of said Railway Company, and that said extended negotiable notes remaining unpaid, matured in the months of February, March, April and May, 1885; that all the rails delivered under the first contract, and about one-half of the rails delivered under the second contract, were paid for by the railway company prior to the appointment of any Receiver of its property, but that the remaining one-half under the second contract, and all rails furnished under the third contract were not paid for; that the rails furnished under the second contract were furnished under a contract made a year and ten months prior to the appointment of the Receiver in the Original Cause, No. 185, and about three years and three months prior to the appointment of the Receiver in the Consolidated Cause, No. 198, and *about six years prior to the appointment of the Receiver in Cause No. 227, in which the present intervention was filed;* that the rails furnished under the third contract were furnished under a contract made about sixteen months prior to the receivership in cause No. 185, and two years and nine months prior to the receivership in the Consolidated Cause, No. 198, and *about five years*

and six months prior to the appointment of the Receiver in Cause No. 227.

The Master also found that all of the rails had been delivered prior to the month of June, 1884, or more than eight months prior to the first receivership.

The Master further found as follows :

"I find that the debt for which the Lackawanna Company claims payment in its petition herein cannot be classed as a debt made in the ordinary course of business as its terms seem generally to be understood ; yet it appears that when the contracts hereinbefore mentioned were entered into between the said Lackawanna Company and the defendant Railway Company, the condition of the track of the defendant Railway Company was such that the demand for new rails upon the most worn portions of the roadway was practically imperative."

And further, the Master found :

"I find that when the aforesaid contracts were made with the Lackawanna Company, both seller and buyer expected the debts to be paid from the net income of the property ; that the credit extended under said contracts was at the request of and for the accommodation of the defendant Railway Company and upon its general credit ; that such sales were made without any stipulation that security should be given by the defendant company for said rails, or that payment therefor should be made out of any particular fund or in any particular way ; that said sales were for an unusually large amount of rails and the defendant was unable to pay cash therefor, and there was no way of obtaining such rails except upon a credit ; and *petitioner herein at the time of the said contracts and sales had knowledge of the mortgage of June 16, 1873*, given by the defendant company upon the properties of its Waco and Northwestern division to secure the First Mortgage bonds, which said mortgage has been herein foreclosed."

See the Findings of the Master's Report as recited on pages 98 *et seq.*, Transcript of Record.

The Master's report was confirmed by the Circuit Court, which dismissed the petition of the intervenor. The intervenor appealed to the United States Circuit Court of Appeals which affirmed the action of the Court below.

The following **Summary of Dates** may be useful:

Main Line H. & T. C. mortgage made in 1866.

First Waco and Northwestern mortgage of the H. & T. C., June 16th, 1873.

First contract between H. & T. C. and Lackawana Iron & Coal Co., December 28th, 1882.

Second *Id.* April 26th, 1883.

Third *Id.* October 30th, 1883.

Receivers of H. & T. C. first appointed February, 1885.

Dismissed and new Receivers appointed, May, 1886.

Decree foreclosure Main Line May 4th, 1888.

Sale under decree, September 8th, 1888.

Complainants bill filed to foreclose Waco and Northwestern mortgage, and Receiver appointed, April 6th, 1889.

Decree March, 1892.

Sale to Green, December 28th, 1892.

Final sale, September 3d, 1895.

Argument.

The debt of the Lackawanna Iron and Coal Company is simply a *general contract debt* for steel rails furnished years ago by that company to the Houston and Texas Central Railway Company, at a given price per ton, for which the railway company was to give its notes, at six months, with a privilege of extension for an additional period of six months. Not a word is said in the contracts as to how the debt was to be paid, nothing about the earnings or any attempted lien thereon; and, as the Master finds, the claim itself was in no sense to be classed with current operating expenses. But the Master

finds that the parties *expected* the debts to be paid out of the earnings. These debts were all contracted more than sixteen months before the railway company was placed in the hands of Receivers in the original cause brought by the Southern Developement Company and subsequently dismissed, and nearly six years before the bill was filed in this cause to foreclose the first mortgage on the Waco and Northwestern Division, and the receivership extended thereunder. There was not a single fact connected with the transaction which gives the intervenor any lien equitable or otherwise. It is purely and simply a sale of rails to the railway company on a credit of six months with the privilege of extension for six months longer.

Before entering upon a discussion of the nature of the transaction and the general bearing upon it of the doctrine usually referred to as the doctrine of *Fosdick* vs. *Schall*, we submit that, even if in other respects, the petitioner could show any equities, yet these old claims upon extended notes were stale before their holder sought to enforce them. It would be obviously inequitable for Courts to recognize against property in strictness belonging to bondholders claims whose owners have not chosen to insist upon them while the railroad was still in control, but who, preferring to wait until the appointment of a Receiver, then for the first time step in relying on the hope of getting in before the bondholders in any event by virtue of such receivership. Justice Brewer, examining certain claims, for which priority was sought, in *Blair* vs. *St. Louis H. & K. R. Co.*, 22 Fed. Rep., 471, said :

"Now for what time prior to the appointment of the Receiver may these credits be sustained ? There is no arbitrary time prescribed, and it should be only such reasonable time as, in the nature of things

and in the ordinary course of business, would be sufficient to have such claims settled and paid. Six months is the longest time I have noticed as yet given. Ordinarily, I think that is ample. Perhaps in some large concerns, with extensive lines of road and a complicated business a longer time might be necessary. Certainly, so far as the present road is concerned, six months is ample. If any person permits a claim to continue longer than that, he certainly has no right to be considered other than as a general creditor with no preference over a secured debt."

The petitioner must claim one of two things—either that by making this contract, it obtained a lien on the property of the railway company, entitled to preference over the then existing mortgages; or that the debt is of such a peculiar nature as to be entitled to priority of payment out of the proceeds of the sale of the railroad.

We assume that the petitioner does not claim a contract lien or mortgage paramount to the existing mortgages. It would be enough to say that the statutes of Texas as to railroad mortgages were not complied with, even if it were otherwise possible to maintain such a claim. What the petitioner claims, therefore, must be a right in equity to be paid out of the fund because it sold to the Railway Company certain rails on credit and did not collect the entire purchase-money, but took notes for it.

The right to priority of one who sells rails was settled against the intervenor as long ago as 1875 in *Meyer* vs. *Johnson* (53 Alabama, 237), in which the State Supreme Court said:

"Iron rails * * * when laid and fastened upon a road, are an essential part of it, and, ceasing to be chattels personal, are subjected, as a part of the road, to the older mortgages thereon,"

and by this Court even earlier, 1870, in the

case of the *Galveston Railroad* vs. *Cowdrey* (11 Wall., pp. 459, 482). There this Court held that when the creditor permitted his rails to go into and become part of the road, he consented to their being covered by the existing mortgages; that he acquired no lien which could displace such mortgages, and that a claim for priority could not be susained. In the case at bar the situation is even stronger in favor of the mortgagee, for the Master has found specifically that the petitioner, when it furnished these rails, *knew of the mortgage upon the railroad property.*

In the case of the *United States* vs. *New Orleans R. R.* (12 Wall., 362), this Court affirmed the principle of the *Galveston* case, and again in *Porter* vs. *Pittsburg Steel Company* (122 U. S., 267).

In the case of the *Atlantic, Mississippi and Ohio R. R.* (3 Hughes, 320), the Court held that those furnishing steel rails were entitled to no priority, as was done in the case of *Olyphant* vs. *St. Louis Ore and Steel Co.* (28 Fed. Rep., 729).

This last case was one in which the Lackawanna Iron and Coal Company, the present petitioner, had contracts for the delivery of rails which were partially carried out, and sought, as it does now, a lien for the balance, which lien was denied and the petition dismissed.

To the same effect is *Bound* vs. *South Carolina Ry. Co.* (58 Fed. Rep., 473).

It is, we believe, without example or precedent that such a claim as that of the intervenor should be sustained. Such claims are mere debts, with no lien or privilege affixed to any property against which they can be enforced in a Court of Chancery.

Until the decision of *Fosdick* vs. *Schall* (99 U. S., 235), in 1878, and contemporary and subsequent

cases, no lawyer would ever have dreamed of going into a court of equity with such a claim.

The present petition is an experiment at a novel, unjust and unauthorized extension and perversion of the doctrine of *Fosdick* vs. *Schall*, and kindred cases, to go far beyond the principles of those decisions, and, in fact, to revolutionize the primary elements and most settled doctrines of equity jurisprudence and practice.

The principle of *Fosdick* vs. *Schall* has been discussed so frequently that any further discussion of it seems to require an apology. We may be allowed, however, to remind the Court of a few matters relevant to that case and which must, we submit, govern the issues here. *Fosdick* vs. *Schall* was a suit by a mortgagee, in which he applied for and obtained a Receiver, the Court imposing a condition that the Receiver should pay out of the *current earnings* all debts due and owing for labor and services rendered in operating the railroad within the next preceding three months, and all indebtedness of engines, iron, wood, supplies, cars or other property purchased within the said period of three months for the use of the company. Schall had a claim for rent of cars, and claimed priority to the mortgage out of the proceeds of the sale of the mortgaged property. The Supreme Court rejected his claim; but the Chief Justice took occasion to lay down the doctrines on which allowances could be rightfully made out of the earnings in the Receiver's hands, or out of the proceeds of the sale of the mortgaged property. This opinion was evidently delivered after great consideration, and has since been repeatedly referred to by the Court as a guiding precedent.

It will be seen from the above summary that the Court in the *Schall* case was simply applying the doctrine that the earnings of a railroad company,

even when its mortgage extends to income, are primarily applicable to the operating expenses of the company until actually sequestered by or for the mortgagee. It therefore held that under certain equitable conditions this income, even after being so sequestered, must be applied to the payment of certain limited classes of operating claims when, but for some diversion *beneficial to the mortgagee*, those claims would have been paid, as required by law, out of the earnings of the company before sequestration. As this Court, speaking through Mr. Chief Justice Fuller, said in the case of *Morgan's Company* vs. *Texas Central Railway Company*, (137 U. S., 171, at page 197),—

"The doctrine of *Fosdick* vs. *Schall* (99 U. S., 235), is that a Court of equity may make it a condition of the issue of an order for the appointment of a Receiver, that certain outstanding debts of the company shall be paid from the income that may be collected by the Receiver or from the proceeds of sale; that the property being in the hands of the Court for administration as a trust fund for payment of incumbrances, the Court, in putting it in condition for sale, may, if needed, recognize the claims of materialmen and laborers, and some few others of similar nature, accruing for *a brief period* prior to its intervention, *where current earnings have been used by the company to pay mortgage debt or improve the property, instead of to pay current expenses, under circumstances raising an equity for their restoration.*"

If any pretense be made here that any current earnings of the railroad company, properly applicable to the payment of the petitioner's claim, were used by the company to pay any part of the debt due under the mortgage on the Waco and Northwestern Division or to improve the property for the benefit of that mortgage, it must be remembered that the contracts un-

der which the petitioner's rails were furnished were all dated before November 1st, 1883, and that the original six months' notes, and the extended notes, had all matured and become enforceable by May, 1885. The first default in the payment of coupons on the bonds secured by this mortgage did not occur until the following year and more than six months after the maturity of the last of the extended notes, and when it did occur, the property was in the hands of the Receiver appointed in the foreclosure suit of the trustees of the mortgage on the main line. Clearly no diversion of income had taken place to the advantage of the Waco and Northwestern Division mortgage and in detriment to the rights of the petitioners.

It is true that the Railroad Company paid some interest on its mortgages, including the Waco and Northwestern Divison mortgage, after these contracts had been made.

But it cannot be claimed that the bondholders, whose interest was so paid by the railroad company, were bound to take notice that the railroad company had incurred a large debt for rails which it had not paid. In the case of *Morgan's Company* vs. *Texas Central Railway Company* (137 U. S., 171), an attempt was made to assert a preference for money loaned because it was used for the payment of coupon interest, but this Court affirmed the action of the Court below in ruling out any such claims.

Nothing could be more certain than that the Court in *Fosdick* vs. *Schall* laid down no doctrine from which it could be justly argued that the current-fund creditor has any *lien* upon the *earnings* or the *corpus* of the property. No one could have said more plainly than the Chief Justice, if such

had been his intention, that the current-earnings creditor has a prior lien to the mortgage creditor, and is entitled for its enforcement to the same remedy in equity that the mortgage creditor possesses for his lien. If such had been the principle of the opinion, so carefully matured and expressed, it would have been made clear. Instead of this, the right of the current-earnings creditor is most carefully subjected to that "sound judicial discretion, which may, under the circumstances of the particular case, appear to be reasonable."

The case of *Express Company* vs. *Railroad Company*, (99 U. S., 191), decided at the same term as *Fosdick* vs. *Schall*, throws the strongest light on this branch of the case. The Express Company advanced $20,000 to the railroad company to be expended in repairing and equipping its railroad, for which it was to have certain express facilities, accounts to be made monthly, and to continue for a year, and until payment of the $20,000. The railroad company then executed a deed of trust to secure mortgage bonds, a foreclosure suit was brought and a Receiver appointed. The Receiver refused to complete the contract, and the Express Company sued in equity for its performance, which, of course, involved compensation therefor. Mr. Justice SWAYNE said, at page 200:

"The appellant has no lien. * * * As well might he (the Receiver) be decreed to satisfy the appellant's demand by money as by the service sought to be enforced. Both belong to the lien-holders and neither can be thus diverted. The appellant can therefore have no *locus standi* in a Court of equity."

Judge DRUMMOND, the father of railroad foreclosures, in *Turner* vs. *Railway Company*, (8 Biss., 315,) said:

"During the discussions which have taken place on this subject, the allowance of these back claims has been sometimes called a lien, but in point of fact it never has been nor can it be justly so called, but, as already stated, is an exercise of the equitable power of the Court in the premises."

Miltenberger vs. *Railroad*, (106 U. S., 286,) decided in 1882 by Justice Blatchford, was a case where default on the first mortgage occurred in November, 1873, on the second mortgage in January, 1874, and suit for foreclosure was brought by the mortgagee in August, 1874. A Receiver was appointed, with directions to pay the arrears due for operating expenses incurred within ninety days, and to pay not exceeding ten thousand dollars to competing lines and for materials and for repairs and ticket and freight balances; also to make certain improvements and purchases, and this was sustained. This Court said in the course of its opinion, page 311:

"It can not be affirmed that no items which accrued before the appointment of a Receiver can be allowed in any case. Many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property for the Receiver to pay preexisting debts of certain classes out of the earnings of the Receivership, or even the *corpus* of the property, under the order of the Court, with a priority of lien. Yet the discretion to do so should be exercised with very great care. The payment of such debts stands *prima facie* on a different basis from the payment of claims arising under the Receivership, while it may be brought within the principle of the latter by *special circumstances*. It is easy to see that the payment of unpaid debts for *operating* expenses, accrued within the *ninety* days, due by a railroad company suddenly deprived of the control of its property, due to operatives in its employ, whose cessation from work simultaneously is to be deprecated in the interests both of the property and of the public, and the payment of limited amounts due to other and con-

necting lines of road for materials and repairs, for unpaid ticket and freight balances, the outcome of indispensable business relations, where a stoppage of the continuance of such business relations would be a probable result in case of non-payment, the general consequence, involving largely also the interests and accommodations of travel and traffic, may well place such payments in the category of payments to preserve the mortgaged property in a large sense by maintaining the good will and integrity of the enterprise, and entitle them to be made a first lien."

It is clear that no idea was in the mind of the Court that those claims or any of them, prior to the Receivership, were liens upon the property. They were claims limited by the Court's description to certain peculiar classes of operating expenses, the payment of which might almost be regarded as a necessity for the preservation of the property. The Receiver had put the payment of this class of claims on the ground that "it was indispensable to the business of the road, and unless authorized to provide for them at once, the business of the road would suffer great detriment. These reasons were satisfactory to the Court." Such claims are widely different from those of a steel company which, knowing of the existence of the mortgage, and relying on the earnings of the road, chose to supply steel rails to the railroad company long before any default on the bonds or the appointment of a Receiver. The remarks of the Court, in the *Miltenberger* case, even if given their widest scope, would apply only to those simple, current debts arising necessarily in the daily business of the railroad, the failure to pay which would result in the practical cessation of that business. It is not merely because the materials furnished by the holders of claims are useful to the road, or because the claimants might refuse to do

business in future with the railroad company, that priorities will be allowed over the mortgage debt. It is to be presumed that railroad companies do not buy things which seem useless for their purposes; and some of the claims in the *Miltenberger* case were expressly disallowed, although "the creditors threatened not to furnish any more supplies on credit unless they were paid the arrears." The most careful discrimination must be exercised in every case, and no disbursement authorized with priority unless some *special* equities appear surrounding that specific claim. What constitutes such special equities, even after the numerous decisions of this Court and other Courts on the subject, still remains somewhat vague; and we respectfully submit that a close review of the authorities will disclose that in every well-considered decision the elements of *consent* or *estoppel on the part of bondholders* will be found to exist, as they undoubtedly existed in the *Miltenberger* case. But, in any event, the Court can find no special equities, in the absence of consent, in favor of claimants such as the present petitioner.

The case of *Trust Company* vs. *Souther*, (107 U. S., 591), arose where default had been made in the payment of mortgage interest due October 1st, 1873, and semi-annually thereafter. On December 6th, 1879, the mortgagee filed a bill of foreclosure and obtained a Receiver, the order appointing him requiring the Receiver to pay and discharge all amounts due and owing for labor or supplies accrued in the operation and maintenance of the road within six months immediately preceding. The net earnings of the receivership exceeded $200,000, which, *with the assent of the mortgagee*, were expended in purchasing additional land and rolling-stock and making permanent improvements of the railroad, all of

which were embraced in the sale, leaving about $65,000 of debts unpaid, of the character which the Receiver had been ordered to pay. The question was as to their right to payment out of the proceeds of sale. The Chief Justice said that their right to such payment was decided by *Fosdick* vs. *Schall* and *Miltenberger* vs. *Railroad Company*, and held that, as the net earnings, instead of being applied to pay the current operating debts as directed, *had been diverted at the request of the mortgagee, to add to the value of the mortgaged property*, the proceeds of sale would, in equity, be held to represent the fund directed to be applied to the labor and supply creditors when the Receiver was appointed.

In *Burnham* vs. *Bowen*, (111 U. S , 776), a mortgage had been executed in June, 1871, to secure bonds for $4,125,000. No interest was ever paid, the company remaining in possession and operating the road until 1875, when a suit for foreclosure was commenced and a Receiver was appointed. The receivership earned over $25,000 of net earnings. All those net earnings, together with the railroad, went into the hands of the mortgagee, by strict foreclosure, but subject to the claim of Bowen, amounting to $6,515.42 for coal sold to the railroad company in 1874—"one of the current debts for operating expenses, made in the ordinary course of a continuing business, to be paid out of the current earnings," and there was no other liability on account of current expenses unprovided for when the Receiver took possession. This claim would have been paid out of current earnings, at maturity, had the Court not interfered, at the instance of the trustees, for the protection of the mortgage creditors.

Out of his earnings the Receiver had paid $7,898, a debt for real estate for the company, and nearly

$18,000 for right of way. The Court held that the right of Bowen for payment out of the earnings by the Receiver, was within the principle of *Fosdick* vs. *Schall*, those earnings having been diverted to payment for additional property to increase the security of the mortgage debt. But the opinion declares, at page 783:

"We do not now hold any more than we did in *Fosdick* vs. *Schall*, or *Huidekoper* vs. *Locomotive Works*, (99 U. S., 258, 260), that the income of a railroad, in the hands of a Receiver for the benefit of mortgage creditors, who have a lien upon it under their mortgage, can be taken away from them and used to pay the general creditors of the road."

In *Blair* vs. *Railway Company*, (22 Fed. Rep,. 471, already cited in another connection, Justice BREWER said, at page 474:

"What claims are entitled to such equitable preference? The Master has reported in favor of all claims accruing since the default in payment of the interest on the mortgage debt—a period of over two years. This seems to proceed upon the assumption that the mortgagees, by failing to take action, have made the mortgagor company their agent to incur debts—have impliedly consented that all such debts shall take preference of their secured claims. I do not think that this principle is sound. There is no implied agency to that extent, and I do not think that the rulings of the Supreme Court are based upon any such doctrine. The idea which underlies them I take to be this: That the management of a large business like that of a railroad company cannot be conducted on a cash basis. Temporary credit in the nature of things is indispensable. Its employees cannot be paid every month. It cannot settle with other roads its traffic balances at the close of every day. Time to adjust and settle these various matters is indispensable. Because in the nature of things this is so such temporary credits must be taken as assented to by the mortgagees, because both the mortgagees and the public are interested in keeping up the road and having it pre-

served as a going concern; and whatever is necessary to accomplish this result must be taken as assented to by the mortgagees. In this view, such temporary credits accruing prior to the appointment of the Receiver must be recognized by the mortgagees and such claims preferred." * * * * * * "Out of what shall these claims be paid? Primarily, of course, out of the earnings of the road, and ordinarily out of such earnings alone. * * * That is fair, because if no receiver were appointed and the claimants attempted by legal process to enforce the collection of their claims they could obtain no priority over the mortgages, but must still be subject to such mortgages. So the appointment of a receiver ought not to give them a priority which they had not before."

Justice Brewer then went on to say that cases may arise in which such claims may be paid even out of the *corpus* of the property, but this is only in exceptional cases, and where *special* equity is shown.

The claim of the present intervenor contains no such special equity, and is not of a character which under a receivership obtained by the mortgagee would entitle it to an equitable preference against either the *earnings* or the *corpus*.

In *Bound* vs. *South Carolina Railway Co.* (58 Fed. Rep., 473,) which was an application by this very petitioner, almost identical with the present application, the Circuit Court of Appeals for the Fourth Circuit, consisting of Chief Justice FULLER and District Judges HUGHES and MORRIS, denied the priority prayed for, using in the course of their opinion the following language, at page 480:

"The rule giving preference to current expenses incurred on the faith of the earnings of a railroad shortly before the appointment of a Receiver has never been carried so far. The debt of the Lackawana Company was an ordinary merchandise debt, evidenced by notes, which were re-

newed from time to time. * * * The Railroad property being heavily mortgaged, all that any unsecured creditors had to look to for payment was the earnings. The immediate earnings, it is clear, the Lackawana Company did not look to, as the sale was upon a credit of eight months. * * * The claim is quite different from those ordinary and necessary current expenses of operating a railroad contracted but a short time before a receivership, and which, by the sudden action of the court in appointing a Receiver are left unpaid."

The effort to bring within the scope of the doctrine of *Fosdick* vs. *Schall*, all manner of general debts of railroad companies has been severely discountenanced by this Court. In the case of *Kneeland* vs. *Trust Company* (136 U. S., 89), it said at page 97:

"No one is bound to sell to a railroad company or to work for it, and whoever has dealings with a company whose property is mortgaged must be assumed to have dealt with it on the faith of its personal responsibility and not in expectation of subsequently displacing the priority of the mortgage liens. It is the exception and not the rule that such priority of liens can be displaced. We emphasize this *fact of the sacredness of contract liens for the reason that there seems to be growing an idea that the Chancellor, in the the exercise of his equitable powers, has unlimited discretion in this matter of the displacement of vested liens.*"

We have quoted from these few leading authorities because they illustrate the real meaning of the rule. We will do no more than refer the Court to some of its many other decisions on this subject, from which, we submit, it clearly appears that the petitioners' claim is not entitled to priority over the bondholders. *Hale* vs. *Frost* (99 U. S., 389); *Huidekoper* vs. *Locomotive Works* (99 U. S., 258); *Union Trust Co.* vs. *Walker*, (107 U. S., 596); *Union Trust Co.* vs. *Illinois Midland R. R. Co.* (117 U. S., 434); *Porter* vs. *Pittsburg Bessemer Steel Co.*

(120 U. S., 649); *Penn* vs. *Calhoun* (121 U. S., 251); *Porter* vs. *Pittsburg Steel Co.* (122 U. S., 267); *Union Trust Co.* vs. *Morrison* (125 U. S., 591); *St. Louis, Alton & Terre Haute R. R. Co.* vs. *Cleveland R'y. Co.* (125 U. S., 658); *Wood* vs. *Guarantee Trust Co.* (128 U. S., 416); *Thompson* vs. *Water Valley R. R. Co.* (132 U. S., 68); *Fogg* vs. *Blair* (133 U. S., 534); *Toledo, Delphos & Burlington R. R. Co.* vs. *Hamilton* (134 U. S., 296); *Louisville, Evansville & St. Louis R. R. Co.* vs. *Wilson* (138 U. S., 501); *Sunflower Oil Co.* vs. *Wilson* (142 U. S., 313); *Quincy R. R. Co.* vs. *Humphreys* (145 U. S., 82); *St. Joseph R. R. Co.* vs. *Humphreys* (145 U. S., 105); *United States Trust Co.* vs. *Wabash Western R'y Co.* (150 U. S., 287); *Thomas* vs. *Western Car Co.* (149 U. S., 95).

These authorities confine the *class* of claims to which priority will be given with great strictness to those expenses which, being operating expenses of a daily character, form part of the necessary current cost of running the road and without which the road could not continue as a going concern. The class does not extend to any other claims, however useful in character or necessary to the general welfare of the road. Original construction claims, for instance, as to the equity of which certainly as much might be said as of the present intervention, are uniformly held to fall outside of the rule. See *Wood* vs. *Guaranty Co.*, *supra*.

But even in the case of claims falling within the recognized class, the earnings of a Receivership cannot be taken away from the mortgagee and given to the unsecured claimant, unless the latter can point to some *diversion* to the use of the mortgagee of earnings, which, in justice, belong to him. To make earnings belong in justice to the current earnings creditor, they must obviously be the cur-

rent earnings of the *Railroad Company* (the sole party who incurred the debt) applicable to the payment of current expenses and earned at the time when the debt was *incurred* or when, in the ordinary course of business, it *matured*. Specifically applying these obvious rules to the case at bar, even if the petitioner's claim were of the class to which Courts have awarded priority (which, as the master found, it is not), the petitioner would still have to show that current earnings of the *Railroad Company*, earned at the time when the debts for the steel rails were *incurred*, or when they, in the ordinary course of business, *matured*, had been actually taken and applied to the benefit of the holders of the bonds secured by the Waco Division mortgage. This, plainly, the petitioner cannot do. If any specific earnings could be considered primarily applicable to the payment of the petitioner's claim, they could only in justice be those earnings of the *Railroad Company* earned at the time (a), when the contracts were made, (b), when the rails were delivered, or (c), when the notes matured.

We understand the petitioner to claim that *during the receivership* certain moneys were paid to the bondholders of the Waco and Northwestern Division for interest on their bonds, which moneys should have been paid on account of the petitioner's debt, and that therefore it is entitled to have at least that amount refunded out of the proceeds of sale. But this begs the entire question. The mortgage creditors are entitled to sequester the income, and they have a right to have such income paid over to them, or applied on the property for their benefit, after the Receiver has paid out of the income the regular operating expenses, and such unpaid bills for operating expenses, etc., as are en-

titled to preference. The fact that the intervenor is a creditor does not give its claim a preference for payment out of the income over the bondholders, who are also creditors, and for whose benefit the income as well as the corpus of the property was especially pledged. The fact that the Railroad Company contracted a debt years before the receivership was begun for the purchase of rails, and used the rails for the improvement of its railroad, does not give that simple contract debt preference over the secured mortgage debt or change its character, so that the unsecured creditor can seize the income or ask that the property be charged with a prior lien for its benefit, because the secured creditor has received some of his interest debt.

It is absolutely essential for the petitioner in the first instance to show that its claim has priority, and that it is such a claim as the Courts recognize as entitled to payment before the payment of the mortgage debt. We have shown that such is not the case; that it never had such right to prior payment, and that if it ever could have asserted such a right the time for its doing so expired long ago. The latest of the petitioner's contracts was made nearly two years before the original receivership in 1885 in the Southern Development case, which was dismissed.

The petitioner's counsel will perhaps seek to draw an argument from the fact that the trustee of the Waco Division mortgage did not file a bill to foreclose that mortgage immediately upon default. But it must not be forgotten that the first default on the Waco Division mortgage did not occur until January, 1886, long after the property had been placed in the hands of a Receiver by another party, and long after the last of

the petitioner's extended notes had matured. Thus the petitioner's claim had arisen, ripened and grown old, before the trustee came into a position to act. How, then, can the petitioner base any equities on the failure of the trustee to begin foreclosure immediately? Its rights having all accrued prior to the default, what effect upon them could the future course of the trustee possibly have? The delay of bondholders to act upon a default cannot of itself create any rights in others. It may, undoubtedly, under some conditions, form an element in a situation which would make it inequitable for delaying bondholders to insist upon their mortgage priority. But such a consequence can plainly not flow from delay where, as here, the claim of the adverse petitioner had become complete, mature and enforceable before the delay began. The rights of the petitioner were preserved by its successive intervening petitions in the three causes, but they were necessarily preserved in their *original* condition. They could not improve by the mere lapse of time, nor could the clauses in the several orders and decrees relating thereto in any way change the relations of the parties. Thus, the whole controversy is relegated back to the original question, which is whether the petitioner had acquired any equity against the Waco and Northwestern Division bondholders at the beginning of the Receivership. As we have already shown that question must be answered in the negative.

As illustrating the part played by delay of bondholders in such proceedings, we call the Court's attention to the cases of *Boom Co.* vs. *Case*, (4 Fed. Rep., 873); *Blair* vs. *St. Louis H. & K. Co.* (22 Fed. Rep., 471); *Farmers' Loan and Trust Company* vs. *Green Bay, W. & St. P. Ry. Co.* (45 Fed. Rep., 664), and *Coe* vs. *New Jersey*

Midland Ry. Co. (31 N. J. Eq., 105). All of these cases were decided on the obvious principles summarized above.

"It has never been decided yet," as the Court said in *The Atlantic, Mississippi and Ohio* Case, (3 Hughes, 340), "that because a mortgagee does not immediately pounce upon his security, foreclose, take possession and sell, that he impairs the obligation of his lien."

The decrees of the Circuit Court and the Circuit Court of Appeals dismissing the intervenor's petition should be affirmed.

New York, January, 1898.

HERBERT B. TURNER,
M. F. MOTT,
Solicitors and of Counsel for the
Farmers' Loan and Trust Company.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1898.

No. 162

LACKAWANNA IRON AND COAL COMPANY, ET AL.

APPELLANTS.

VS.

FARMERS' LOAN AND TRUST COMPANY, ET AL.

APPELLEES.

BRIEF FOR APPELLEES MORAN BROS. AND HENRY K. McHARG.

The subject of appellant's intervention in the Circuit Court was the sale and delivery by the Lackawanna Iron and Coal Company to the Houston and Texas Central Railway Company, prior to the appointment of a receiver over the property of said company, and during the years 1882 and 1883, of 18,581 tons of steel rail at an aggregate agreed price of $735,454.30.

The object sought by intervenors in this proceeding is to obtain priority in the payment of their claim over the mortgage bond-holders out of the proceeds of the sale of the property, or the net income arising from the operation of the road. The claim was referred to a special master who was ordered to hear the evidence and report the facts to the Court. The complainant and these appellees intervening bond-holders appeared before the master and after pleading the general issue, specially pleaded that the claim was stale and barred by laches and barred by the Texas Statue of four years limitation. The master in due time filed his report, which was not excepted to and is copied in full in the record. Upon the hearing a decree was entered confirming the report and dismissing the petition. From the decree of the Circuit Court appellants appealed to the Circuit Court of Ap-

peals and the decree of the lower Court was by that Court affirmed for the reasons set forth in its opinion copied in the record, pages 130 to 140 and the case is here on certiorari, granted by this Court.

First Proposition.

Before a debt contracted by a Railway Company prior to the appointment of a receiver will be given priority over the debt of the bond-holders secured by a prior mortgage on the road, it must appear in cases where the debt is for supplies or material, (1) that it is the purchase price of current supplies needed from time to time to keep the road in repair, (2) bought on temporary credit, which credit resulted from the nature and character of railroad business, (3) that such purchase was made within a reasonable time prior to the appointment of a receiver of the property.

STATEMENT.

1. The master finds: "I find that the debt for which the Lackawanna Claims payment in its petition, *cannot be classed as a current debt*, made in the ordinary course of business; * * * that the credit extended under said contracts was at the request of and for the accommodation of the defendant Railway Company, and *upon its general credit*, * * * without any stipulation that security should be given by the defendant company for said rails, or that payment therefor should be made out of any particular fund or in any particular way; that said sale was for *an unusually large amount of rails*, and defendant was unable to pay cash therefor." (R. p. 104.) The magnitude of these dealings becomes apparent upon an examination of the master's findings. In the period of about fourteen months defendant bought of the Lackawanna Company 18,581 tons of rail, at an aggregate cost of $735,454.30, which at 88 and 84.86 tons per mile for 56 and 54 pound rails respectively, were sufficient to construct anew 214.77 miles of track. (R. p. 98 to 104.)

2. The master further finds: "I find that negotiable promissory notes were given petitioner by the defendant company for all rails sold under the three contracts; *that all of said sales were made on a stated credit for a fixed period of time*, viz: six months after the average date of each delivery, and that said *defendant company had the right, under said contracts, to extend the time six months longer from the maturity of said notes;* that such extensions were made for the accommodation and *to suit the convenience of said defendant company and* that said extended negotiable *notes remaining unpaid matured* as shown in clauses 2 and 3, *during the months of February, March, April and May, 1885.*" (R. p. 103.) The above finding shows that the credit was voluntarily extended, and did not result from the nature of the business or necessities of the case.

3. The sales were not made within a reasonable time prior to the appointment of a receiver over the property. On this subject the master finds:

"I find that all the rails delivered under the first contract, and about one half of the rails delivered under the second contract were paid for by the Railway Company prior to the appointment of any receiver of said property, but that the remaining half under the second contract, and all rails furnished under the third contract, are not paid for.

"I find that the rails furnished under the *second contract* were furnished under a contract made *a year and ten months prior to* the appointment of the receiver in cause No. 185, and about *three years and three months prior to* the appointment of a receiver in Consolidated Cause No. 198, and about *six years prior to* the appointment of the receiver in *this cause.*

"I find that the rails furnished under the *third contract* were furnished under a contract made about *sixteen months prior to* the receivership in cause No. 185, and about *two years and nine months prior to* the receivership in Consolidated Cause No. 198, and about *five years and six months prior to* the appointment of a receiver in *this cause.*" R. p. 103.) (Italic ours.)

This report was not excepted to by any one and at the hearing of the case in the Circuit Court was in all things confirmed (R. p. 121-2.) but the testimony heard by the Master and the Circuit Court was not brought up and is not in the record. The report of the Master was substantially adopted by the Circuit Court of Appeals in the following language: (Italics ours.)

"The case of Burnham vs. Bowen, *supra*, relied on by the intervener's counsel and claimed to be analogous in principle to the instant case, was based on a demand for coal used in running the locomotives, supplied to the railroad company a few months before the appointment of a receiver, and the claim was found by the Supreme Court to be, "One of the current debts for operating expenses made in the ordinary course of continuing business." We discover no similarity of principle between that case and the case at bar, Coal is an article of constant and uninterrupted consumption on a railroad, and its purchase at short intervals, for the purpose running the locomotives in quantities not exceeding the operating requirements of the road are clearly current expenses of the road. But it is difficult to see how the purchase of 20,000 tons of rails made under the circumstances stated in the intervenor's own pleadings can be a current debt, "for operating expenses made in the ordinary course of continuing business." *If the road was in the condition of delapidation, which is inferable from the intervenor's averments, it might be sufficient to say, in denying the demand that the rails were supplied, not as a matter arising in the ordinary course of a railroad's operations, but for the virtual reconstruction of the road.* No authorities need be cited to establish the prop-

osition that works of reconstruction are not entitled to preferential payment."

And further on the court say:

"The unusually large purchase of rails; the time within which they were to be delivered, the condition of the road, the contracts providing for notes at six months renewable for a like term at the maker's option, the hypothecation of secureties for the payment of the claim, the knowledge which the intervenor had of the mortgage, the fact that the contracts contained no promise to pay out of any particular fund, the time which elapsed between the date of the contracts and the appointment of a receiver in cause No. 185— are circumstances, which taken together cannot fail to convince us that the *intervenor relied upon the general credit of the railway company.*" R. p. 134 and 140.

This court in the case of Stewart vs. Hayden, 169 U. S. p. 1; 18th Supreme court Rep., page 274, uses this language, "We will add that, as the circuit court and the circuit court of appeals agreed as to what were the ultimate facts established by the evidence, this court should accept their view as to the facts, unless it clearly appeared that they erred as to the effect of the evidence. Morewood v. Eneguist, 23 How. 391. The Ship Marcellus, 1 Black, 414, 417; Dravo v. Fabel, 132 U. S. 487, 490, 10 Sup. Ct, 170; Companio De Navigation La Flecha vs. Brauer. 168 U. S. 104, 123, 18 Sup. Ct. 12." See also The Carib Prince, 170 U. S. 645, 18 Sup. Ct, Rep. 753. We assume from the foregoing that this court will not review the findings of fact thus concurred in by both the Circuit Court and the Circuit Court of Appeals. But if this court were disposed to go into the evidence, we call attention to the fact that no exceptions were taken to the master's report and that no evidence is brought up in the record. Appellants have therefore deprived this court of the opportunity of examining the evidence. The facts being established that the claim cannot be classed as a current debt, that the rail was sold upon the general credit of the Railway Company, and in unusually large quantities, and for virtually reconstructing the road, we invite the court's attention to the law as announced in a few of the leading opinions of this court arising out of a similar state of facts.

The case of Fosdick vs. Schall 99 U. S. 235 is cited and relied on by appellant's counsel and by us. The principles settled by that case are familiar to this court and control this one and fully support the opinion of the Circuit Court of Appeals in this case. That was a case where priorty was claimed by a creditor for rent of certain cars sold to the Railway Company prior to the appointment of the receiver. The priority was denied by this Court and in concluding the opinion, the court used this language: (Italics ours.)

"There is nothing to show that the current income of the receivership or of the Company has been in any manner employed so as to deprive this creditor of any of his equitable

rights. In short, as the case stands, no equitable claim whatever has been established upon the fund in court. *Prima facie* that fund belongs to the mortgaged creditors, and the presumption which thus arises has not been overcome. Schall, for the balance, his due, after his own security has been exhausted, occupies the position of a *general creditor* only."

In the case of Huidekoper vs. Locomotive works, 99 U. S. 258, decided at the same time the distinction between a general debt of the company and debts for current or other expenses is made very clear, and having applied that distinction in the latter case, this court denied the claim for priority in this language, (italics ours.) "We think the case is settled by that of Fosdick v. Schall, supra. p. 235. The amount found due the locomotive company *is not in reality for the use and repairs of the engines, but on account of what was agreed to be paid for the purchase.* The railroad company contracted to buy the engines and pay a certain price. The locomotive company retained a paramount lien to secure the sum to be paid. The debt so incurred was not paid. The lien of the locomotive company has been in effect foreclosed, and the balance of the debt still remains due. Whatever may have been the form of the transaction, this is its substance. So far as we can see, *no equitable claim upon any fund in court has been established as securety for this debt. The locomotive company occupies the position as general creditor with no special equities in its favor.*"

The case of Burnham vs. Bowen, 111 U. S. p. 776, is relied on by counsel for appellants as supporting their claims to priority. We call attention to the language of Chief Justice Waite showing that the claim allowed in that case was for current expenses, etc. In delivering the opinion of the court, among other things he said (italics ours), "In the agreed facts, upon which the case was heard below, it is stated that the coal was furnished during the year 1874, but the precise time in the year is not given. From what does appear however, *we are satisfied that, at the time of the appointment of the receiver, this was one of the current debts for operating expenses made in the ordinary course of a continuing business, to be paid out of current earnings*, and that the payment would have been made at the time agreed on if the Company had remained in possession." And further he said: "In the present case, as we have seen, *the debt of Bowen was for current expenses and payable out of current earnings.*" The foregoing extracts from the opinion clearly show that the case turned on the fact that the claim was for current expenses and of course that case is not authority for this one.

The case of Hale vs Frost 99 U. S. 391 is also cited by counsel as supporting their claim to priority. The opinion in that case is short but the distinction is again recognized between claims for current expenses and material for construction purposes and as an authority it is destructive of appellants' claim for priority. In that case there were two appellants, the Union Car-spring Manufacturing Company and Hale, Ayer & Co., and

both intervened in the receivership and claimed priority over the mortgage bondholders. The Union Car-Spring Manufacturing Co's. claim was for car springs and spirals, amounting to $469.42, which the receiver after his appointment continued to use, but had not paid for. The claim of Hale, Ayer & Co. was for the total of $21,738.92, of which amount $5,919.25 was for supplies, for the machinery department; $14,944.24 for material for construction purposes, and $875.43 interest. The court in passing these claims say, "The Union Car-Spring Manufacturing Company is entitled to payment in full, and Hale, Ayer & Co. to payment of so much of their claim only as is for supplies to the machinery department. There is nothing in the case to show any special equities in their favor in respect to that part of their account which is for *material for construction purposes.*" Thus it will be seen that the Union Car-Spring Manufacturing Company was allowed in full the whole of their claim, because the claim was for current expenses used in the operation of the road. That portion of the claim of Hale, Ayer & Co. which was for supplies to the machinery department, and which of course was for necessary expenses of the road, was allowed its priority, but that portion of the claim which was for construction purposes was disallowed. Enough has been said to show that the cases cited by appellants do not support the contention that a claim such as the facts show theirs to be has ever been given priority, and we assert that no case can be found which will support the claim to priority here asserted so long as the facts found by the lower courts are not upset and a new set of facts put in their place. These facts put appellants' case at war with every case where priority has been decreed. But appellants contend that the findings of the master that when contracts were made for the purchase of the rail that the track of the defendant Company was such that the demand for rails on the most worn portion was imperative; that the condition of the road was bad; that there was continuous breakage of rail and wrecking of trains; that the track was unsafe; that damage to merchandise, rolling stock, etc., was continuous, and that the need for new rail seemed to have been absolutely necessary as a preservation for human life, the loss of which was liable to occur at any moment, brings their case within the doctrine allowing priority. These facts prove too much, and show that the view taken of this purchase of rail by the Circuit Court of Appeals is correct that it was for virtually reconstructing the road. The master found that the sale was of an unusually large amount of rail upon the general credit of the railway company, and that the claim could not be classed as a current debt. Attention is again called to the fact that 20,000 tons of rail were contracted for in about fourteen months, and that 18,581 tons of rail were actually delivered under the contracts at the price of $735,459.30, sufficient in amount to lay down 214.77-100 miles of new track on the road of a railway company which owned only about 500 miles of road. The court's attention is also called to the fact that these intervenors in setting out their claim describe the quantity of rail used by the

mile and the claim is in the same manner reported by the Master by the mile, R. p. 104, and this method of describing the claim of these interveners is constantly used by the solicitors for appellants in their brief, page 7. It appears that the track as it existed when this rail was purchased was taken up bodily, and a new track laid down with these rails, which makes a clear case of purchase and use for general construction purposes. R. p. 104. In Thomas vs. Western Car Company 149 U. S. 95, this court say, "The case of a corporation for the manufacture and sale of cars, dealing with a railroad company, whose road is subject to a mortgage securing outstanding bonds, is very different from that of workmen and employes, or of those who furnish from day to day, supplies necessary for the maintenance of the railroad. Such a company must be regarded as as contracting upon the responsibility of the railroad company, and not in reliance upon the interposition of a court of equity." In the latter portion of the opinion this court again took occasion to recognize the distinction between claims for repairs and claims for construction. The court say, "Assuming, then, that the proportion of the amount shown to have been expended in the renewal of these cars was $80.00 per car, and the rest in ordinary repairs of the kind contemplated by the contract, and deducting from the claims as made for the entire number of cars, to wit, $19,695, the estimated cost of reconstruction, as certified to by Huidekoper, $13,920, there remains the sum of $5,775, representing ordinary repairs, and to that extent we approve the decree of the court below in allowing for repairs."

The contention that the claim is entitled to priority on account of the claimed urgent and pressing necessity for the rail about the time thecontracts were made was fully met and overcome in the opinion of the Circuit Court of Appeals. That Court said:

"That the necessity for supplies does not entitle to preferential payment unless the supplies are for current expenses in the ordinary course of operation, it is forcibly shown by the case of Morgan's L. & T. R'y. Co. vs. Texas Central R'y. Co., 137 U. S., 171, in which it was substantially held that the mere fact that money was loaned to a railroad company to pay the interest on its first mortgage bonds, does not entitle the lender to preference, and that although advances of money may have enabled a railway company to maintain itself, that fact alone does not entitle the lender to priority. The contention that the intervenor is entitled to preference, because the rails supplied to it must have enhanced the value of the bondholders' security is clearly untenable. In Railway Co. vs. Cowdry, 11 Wall, 482, Mr. Justice Bradley, as the organ of the court, said:

"As to the point of giving priority to the last creditor for aiding to conserve the thing, all that is necessary to say is, that the rule referred to has never been introduced into our laws except in maritime cases which stand on a particular reason," Also see Thomson vs. White Water Valley R. R., 132 U. S. 68;

Jones on Corporate Bonds and Mortgages, sec. 584; Fogg vs. Blair, 133 U. S. 534; Toledo R. R. Co. vs. Hamilton, 134 U. S. 296.

The claim asserted in last case was the price agreed to be paid to Thomas Hamilton, a contractor, who intervened and showed that under three several contracts with the Railroad Company, he constructed a dock on the Maumee River, in the City of Toledo. The lot on which the dock was built was a part of the railroad property covered by the first mortgage given by the Company. The Circuit Court sustained the claim of Hamilton and decreed prior payment on the amount due him out of the proceeds of the sale of the railroad property, and based the right of recovery on the ground of superior equity. Mr. Justice Brewer in delivering the opinion of the court says:

"We think that the views of neither the master nor the court can be sustained, and that it was error to give appellee priority over the mortgage. It will be noticed, and it is a fact which lies at the foundation of this case, that the contracts for the construction of the dock was not made till more than three years after the execution and the record of the mortgage. The record imparted notice to Hamilton and to all others, of the fact and terms of the mortgage; and the question is thus presented, whether a railroad company, mortgagor, can, three years after creating by recorded mortgage an express lien upon its property, by contract with a third party displace the priority of the mortgage lien. It would seem that the question admits of but a single answer. Certainly, as to ordinary real estate, no one would have the hardihood to contend that it could be done, and there is in this respect no difference between ordinary real estate and railroad property. A recorded mortgage, given by a railroad company on its road-bed and other property, creates a lien whose priority cannot be displaced thereafter, directly by a mortgage given by the Company, nor indirectly by a contract between the Company and a third party for the erection of buildings or other works of original construction," and further on he says:

"Neither did the fact of the construction of the dock and the subsequent improvement of the mortgaged property, give, as reported by the Master, to Hamilton, an equitable lien prior in right to the lien of the mortgage, or furnish equitable reasons why the legal priority belonging to the mortgage should be displaced. It is true, cases have arisen in which, upon equitable reasons, the priority of a mortgage debt has been displaced in favor of even unsecured subsequent creditors. See St. Louis, etc., R. Co. vs. Cleveland, etc. R. Co., 125 U. S. 658, 8 Sup. Ct, Rep. 1011, in which many of these cases are collected, and the equitable principles underlying them stated. But those principles have no application here. The work which

Hamilton did was in original construction, and not in keeping up, as a going concern, a railroad already built. The amount due him was no part of the current expenses of operating the road."

In Morgan's Louisiana & Texas Railroad & Steamship Co. vs. Texas Central Railroad Company, 137 U. S., p. 171; 11th Supreme Court Reporter, page 69 this court says:

"To allow another corporation, which for its own purposes has kept a railroad in operation in the hands of the original company by enabling it to prevent those who would otherwise be entitled to take it from doing so, a preference in reimbursement over the latter on the ground of superiorty of equity, would be to permit the speculative action of third parties to defeat contract obligations, and to concede a power over the property of others which even governmental soverignty cannot exercise without limitation. And if all these advances should be considered as applied in payment of the operating expenses only, upon the theory, where such was not literally the fact, that they supplied a deficit created by the payment of interest out of the gross earnings, the same remarks would be applicable."

Counsel for appellants cite Miltenberger vs. Loganport C. & S. W. R. Co., 106 U. S, 285, 1 Sup. Court Reporter, 140. Examination of the opinion delivered in that case shows that it decides nothing new but is in harmony with the other decisions of this court. The opinion in that case was delivered by Mr. Justice Blachsford, and among other things he says; (Italics ours.) "Many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property, for the receiver to pay preexisting debts of certain classes out of the earnings of the receivership, or even the *corpus* of the property, under the order of the court, with a priority lien. Yet the discretion to do so should be exercised with very great care. The payment of such debts stands *prima facie*, on a different basis from the payment of claims arising under the receivership, while it may be brought within the principle of the latter by special circumstances. It is easy to see that the payment of unpaid debts for operating expenses, accrued within ninety days, due by a railroad company suddenly deprived of the control of its property, due to operatives in its employ, whose cessation from the work simultaneously is to be deprecated, in the interests both of the property and of the public, and the payment of limited amounts due to other and connecting lines of road for materials and repairs, and for unpaid ticket and freight balances, the out come of indispensable business relations, where a stoppage of the continuance of such business relations would be a probable result, in case of non-payment, the general consequence involving largely, also, the interests and accommodation of travel and traffic, may well place such payments in the category of payments to preserve the mortgaged property in a large

sense, by maintaining the good will and integrity of the enterprise, and entitle them to be made a first lien."

Counsel for appellants cite the case of Union Trust Company vs. Souther, 107 U. S. 591: 2 Sup. Ct. Rep. 295. The claim prosecuted for priority in that case by Souther Bros. was for the sum of $532.14 "for supplies." The statement of the case does not make it clear that the supplies were used as part of the current expenses of the road, but leaves the clear inference that they were as a reading of the opinion will show. The size of the claim would indicate the same thing. If they were, the decisions is clearly right and in accord with every decision of this court before and since. One thing is clear. The supplies in that case were not sold on the general or personal credit of the Company, were not used for virtually reconstructing the road and the case is not an authority for decreeing priority to appellants' claim.

The case of Union Trust Company vs. Illinois Midland Railway Company, 117 U. S. 134, 6 Supreme Court reporter, 809, is cited by counsel for appellants. I have read this opinion with some care and find that the only claims passed upon in the opinion, seeking priority over the mortgage bond holders were those of Warring Bros. These claims were denied priority in the court below, and this court after full consideration of the case affirmed the judgement of the lower court. The case is not an authority for any point involved in this appeal. The case of Union Trust Company vs. Morrison, 125 U. S. 591, 8 Supreme Reporter 1004 is cited also. The Syllabus of that case gives in substance all that is decided in the opinion, and which is as follows: "Where the mortgaged rolling stock of a railroad is in peril of seizure under a judgment, and the railroad claiming the judgement to be wrongful, obtains an injunction against such seizure, one who becomes surety on the injunction bond, the injunction having been dissolved, and judgment recovered against him, has an equity to be paid out of the property of the railroad which is sold to the mortgages at the foreclosure sale, especially when they have purchased expressly subject to intervening claims that may be declared paramount, where the receiver has used earnings to increase the *corpus* of the estate, and where the surety has shown an intention to look to the company's property, as well as its personal security by taking a chattel mortgage on certain locomotives."

The above ~~quotation~~ quotation shows that the decision is not an authority for any point involved in this appeal.

The case of Virginia & A. Coal Co. vs. Central Railroad & Banking Company, 170 U. S. 355 18 Supreme Court Reporter, p. 657, in the last decision of this court within our knowledge on the subject of preferential claims. The opinion in that case was delivered May 9th, 1898. This opinion was delivered so recently we assume the facts of the case and the points decided are fresh in the memory of the members of the court, and will not burden the court with a statement of the case, other than to say

that the claims asserted in that case were for coal furnished by two caol companies to the railway company prior to the appointment of the receiver. Mr. Justice White in delivering the opinion of the court in that case, after stating the case and quoting with approval the opinions of this court in the cases of Wallace vs. Loomis, and Burnham vs. Bowen, says: (Italics ours).

"The equity thus held to arise when a purchase of necessary current supplies is made by owning company, is not in any wise influenced by the fact that the company itself is the purchaser of the supplies, *but it is solely dependent upon the fact that the supplies are sold and purchased for use, and that they are used in the operation of the road; that they are essential for such operation; and that the sale was not made simply upon personal credit, but upon the tacit or express understanding that the current earnings would be appropriated for the payment of the debt.*" And further on he says: "Upon the evidence contained in the record, we hold that the contract upon which both interveners relied—the deliveries of the coal furnished by the Sloss Company being under the contract which had been made with the Virginia Company—was made with the Danville Company, but we conclude from the terms of the contract that *the intentions of the parties was that the coal was to be used in the operation of the lines of the Central Company, and that the mining companies did not reply simply upon the responsibility of the Danville Company, but, on the contrary, that the coal companies looked to the earnings of the Central system as the source from which the funds to pay for the coal to be furnished were to be derived.*" And concluding the opinion, he says "In concluding that the claims of the interveners were entitled to priority of the surplus earnings which arose during the control of the road by the court, we must not be understood as in any wise detracting from the force of the intimations in the recent utterances of this court in Kneeland vs. Trust Co., 136 U. S. 89. 10 Sup. Ct. 950 and Thomas vs. Car Co. 149 U. S. 95,13 Sup. Ct. 824, cases *as to the necessity of a court of equity confining itself within very restricted limits in the application of the doctrine that in certain cases a court having a road fund under its control may be justfied in awarding priority over the claims of mortgage bondholders to unsecured claims originating in a receivership.*" In the Kneeland case, however, the claim refused priority was based upon an alleged instrument of lease, and was for four months' rental of cars operated on a line of railroad by a receiver appointed at the suit of a judgment creditor, such receiver being suceeeded in office by a receiver apppointed in the foreclosure proceedings instituted by the trustees of the mortgage bondholders. It was held that the alleged contracts of lease were in substance and effect, "Antecedent contracts of sale" that in those contracts ample provisions had been made by the vendor for his security by stipulation authorizing a retaking of the property upon failure to make payment promptly of the installments of purchase money as they become due, and that the claim against the fund was in reality for a portion of the purchase price of the cars. Under these circumstances the

debt was held not to be embraced "in the few specified and limited cases" in which this court "has declared that unsecured claims were entitled to priority over mortgage debts," and particular attention was called, among other things, to the fact that the receivership at the suit of the judgment creditor was not for the benefit of the mortgage bondholdors, so that it could not be asserted that the expenditures of such receivership were payable, in any event, out of the income or corpus of the property; and the fact was also noticed that from the time of the purchase of the rolling stock in question in the suit to the time of the final disposition of the mortgage foreclosure, the receipts did not equal the operating expenses, and there had been no diversion of the current earnings, either to the payment of interest or the permanent improvement of the company. In the Thomas case, claims for rental of cars, which rental had accrued prior to the receivership, were denied priority over the mortgage bonds; but the facts in that case were such as to justify the conclusion that car company contracted, "upon the responsibility of the railroad company and not in reliance upon the interposition of a court of equity." In neither the Kneeland nor the Thomas case were there any intention to question the prior decisions of the court, *which allowed priority to claims based upon the furnishing of essential and necessary current supplies, not sold upon mere personal credit*, against the surplus income arising during the operation of the road under the direction of a court of equity."

This opinion brings sharply to view the fact that a claim to be entitled to preferential payment must be for current operating expenses and that the material must not be sold or furnished on the individual responsibility or general credit of the railway company. These propositions are repeated in the opinion and are brought so prominently to the front, to leave no shadow of doubt as to the views of this court on this important subject. The claims were allowed priority in that case because the evidence showed them to be the purchase price of coal used and consumed in the operation of the road and further that the coal was not sold on the individual responsibility of the railway company. The claim in the case at bar was by the lower courts denied priority because the rail was bought on the general credit of the railway company in unusually large quantities for the purposes of virtually reconstructing the road and because it could not be classed as a current debt. The decisions of the lower court are therefore in harmony with the above case and with all the decisions of this court on the subject.

From the foregoing and indeed from all the cases on this subject it is plain that a claim to be entitled to priority must *in fact* be a part of the current expenses of the road. If it is then it may be entitled to the priority whether the demand for the material or labor was ordinary, great, pressing or imperative. The priority is not made to depend in any case on supply and demand or the imperativeness or needfulness of the labor or mate-

rial or whether it was simply needed, badly needed or very badly needed. And upon the other hand if the claim is found *as a fact* to be not for current expenses, but a general or floating debt of the company or for purposes of general construction it is never entitled to priority whether the demand for the labor or material was ordinary or was great, pressing or imperative. Neither in this case is the right to priority made to turn upon supply and demand or the pressing necessities of the situation. The distinctions between the two classes of claims never run along such lines but always turn on the *class* of the claim. The maritime doctrine of salvage has not been adopted in this class of cases—but has been held by this court to furnish no analogy or aid in determining questions of the character under consideration. So the fact that the rail in this case was badly needed cannot alter the nature of the claim, and change it from that of a general debt to that of a special debt, so long as the facts in the record show that the claim cannot be classed as a current debt, and show that the rail was sold in unusually large quantities on the general credit of the railway company and for virtually reconstructing the road. It is always to the nature of the claim that we look to determine its class. Was it one of the current claims for necessary expenses of operation? If not it is not entitled to priority. This is the whole circuit of the inquiry. How badly the material or supplies were needed cannot be looked to in classing the claim. No case has within our knowledge turned upon that point.

Credit must be temporary and result from the necessities of the business.

Blair vs. Ry. Co., 22 Fed. Rep., 471.

Debt must have been contracted short while prior to appointment of receiver.

Thomas vs. Peoria Ry. Co., 36 Fed. Rep., 808.
Turner vs. Indianapolis Ry. Co., 8 Biss, (U. S.) 315.
Fosdick vs. Scholl, 99 U. S., 235.
Union Trust Co , vs. Ill. Mid. Ry. Co., 117 U. S., 434.
Taylor vs. Ry. Co., 7 Fed., 377.
Miltenberger vs. Logansport R. Co., 106 U. S., 286.

Six months seems to be the general rule, which may be deduced from the authorities, and it is only in cases presenting strong equitable features that back debts of longer standing will be given piority. No exceptional equity seems to be claimed in this case, or if claimed none is shown. In this case the last contract was made sixteen months prior to the first receivership and five years and six months prior to appointment of receiver in this cause. (R. p. 103.)

Second Proposition.

The effect and the only effect of a finding that a back debt was contracted an unreasonable time prior to the appointment

of a receiver is to take the claim out of the preferred column and place it among the general floating indebtedness of the company, and when this is done by a direct finding that the debt was contracted upon the general credit of the company, it is not material whether it was contracted a reasonable or unreasonable time prior to the appointment of a receiver.

STATEMENT.

The master finds that appellants' claim is *not a current debt*, and was contracted on the *general credit* of the company. (R. p. 103.)

Thomas vs. Peoria Ry. Co., 36 Fed., 808.
Manchester Locomotive Works vs. Truesdale, 44 Minn., 115.

Third Proposition.

Before a debt for current supplies will be given priority it must appear that the order appointing the receiver made provision for the payment of such claims or that there has been a wrongful diversion of the current revenues of the road which should or would have been used in the payment of such debt to the payment of bonded interest or permanent improvement of the property covered by the mortgage, and the extent of such priority will be limited to the amount diverted. Neither fact exists in this case.

STATEMENT.

1. There is no provision in any of the orders appointing receivers in causes 185, 198 and 227 for the payment of back debts.

2. There has been no diversion of the income of the road to the payment of bonded indebtedness or permanent improvements which should or would have been used for the payment of appellants' debt either by the railway company prior to receivership of said property or by any of the receivers since. All interest appears to have been paid on bonded indebtedness up to January 1, 1885, when the first default occurred. No interest has been since paid on first mortgage bonds of the Waco division, except $91,371.00 paid by order of the Court by the receivers in cause 198 on about May 1, 1887, being the installments of interest which matured January 1 and July 1, 1885, and interest thereon to date of payment (R. p. 114.) This is all the interest that has been received by those bond holders for a period of twelve years. The rail in question was sold under two separate contracts; one dated April 26, 1883, under which 5,009 tons of 56-pound rail at $39.50 per ton were delivered during the months of June, August and September, 1883. (R. p. 100.) The other contract is dated October 30, 1883, under which 8,552 tons of 54 pound rail at $36.60 were delivered during February, March, April and May, 1884. (R. p. 101.) The contracts of sale provide that the rail is to be paid for in notes at six months with six per cent. interest, with privilege in the Railway Com-

pany to extend time of payment six months longer. In accordance with the terms of these contracts, notes were given and which were renewed and extended from time to time, so that all the notes due petitioner matured after January 1, 1885, and during the months of February, March, April and May. (R. pp. 100 to 101.) Petitioner having extended the time of payment could not in the meantime prior to the maturity of the notes demand payment of said notes, and cannot now complain of interest payments being made before the maturity of its own notes. The record shows that the bonded interest of the railway company was payable semi-annually on January 1 and July 1. Interest was paid January 1, 1883, July 1, 1883, January 1, 1884, and July 1, 1884, by the company. All these payments were long prior to the maturity of petitioner's debt. It can in no sense be said that these interest payments was a diversion of the stream from its natural channel. It cannot be presumed that this money would have been paid appellants but for the interest payment, for at that time the company owed appellants no matured debt. Appellants are therefore estopped by their own contract in first giving time and afterwards extending time of payment from claiming the money used in paying interest on the bonded debts from the date of the sale in 1883 to maturity of the debts in February, March, April and May, 1885.

Our position is that appellants cannot complain of the payment of any valid debt of the company which was in existence when the rail was sold, and of which it had notice, and which matured prior to the maturity of their debts. This would give all interest installments which matured prior to the February, March, April and May, 1885, priority over the debt of appellants and of course would include the installment of interest which matured January 1, 1885. The receivers in cause 185 were appointed February 20, 1885, and the property has been in the possession of receivers in causes 185, 198 and 227 continuously since. As stated above no interest was paid in causes 185 or 227, and of the payments made May 1, 1887, one-half was for interest which matured January 1. 1885, and which matured prior to the maturity of any of appellant's notes, and which appellants must have understood would be paid at maturity. The whole of said interest payment of May 1, 1887, was made on application to the Court in cause 198, to which cause appellants were parties. If appellants were in law or in fact entitled to said fund in preference to the bond holders, in that cause, and on that occasion, was the time and place to have asserted their rights thereto. Besides the order was made without prejudice. On this subject the master finds:

"I find that said order expressly declared that it was 'without prejudice to the rights of defendant or of any intervenor in this cause, or any final decree to be rendered in the same, nothing herein being decided as to the merits of the claim of the defendants, or of intervenors, and this order not in any manner estopping or affecting the rights of any party or intervenor in this cause.'" (R. p. 117.)

If this money was received by the bond holders without prejudice they are surely not to be harrassed in after years in a separate suit with a serious charge that this interest was wrongfully taken from one of the very creditors who was a party to the cause and participated in taking the order. The bonds and mortgage securing same are admitted to be valid and unpaid, and if the bond holder is not protected by the above provision against the charge of diversion in accepting this interest, then it may be truly said that this money was taken with great probability that the act of doing so would be very prejudicial, indeed to the extent of refunding every dollar received with interest thereon at the end of an expensive lawsuit. The order was doubtless intended to provide for the payment of a debt which was conceded to be valid, but that in doing so no precedent should be established as to who was entitled to priority in payment out of the net income or proceeds of sale of the road as a protection to petitioner and other parties and intervenors who were asserting priority over the bond holders, and that the bond holder, on the other hand, in accepting the money, should not be charged with diverting that money from the other claimants. If the above is a valid interpretation of the order it is manifest that no diversion has been shown by way of interest payment.

It only remains to be considered whether there has been a wrongful diversion of funds in the erection of betterments and permanent improvements on the Waco branch. On this subject the master finds:

"I find that no interest has been paid on the bonded indebtedness by either of the receivers in this cause; I find that Alfred Abeel, receiver in this cause, has expended, under the orders of this court, $46,505.40, for betterments and permanent improvements, from December 10, 1892, to September 3, 1895, consisting of bridges, shops and round houses, car shed, water stations, locomotives, chair car and fencing." (R. p. 109.)

"I find that no part of the income arising from the operation of the road and no part of the proceeds of sales of old rails, old iron, old cars and engines, which was received by the receivers in causes Nos. 185 and 198, ever came into the possession of the receiver in this cause, and the evidence fails to show that any part of the new equipment purchased by the receivers in causes Nos. 185 and 198, as shown above ever came into the possession of the receivers in this cause. The evidence fails to show that any improvements and betterments of the property added to the property of the Houston and Texas Central Railway Company by the receivers in causes Nos. 185 and 198, were made on the Waco and Northwestern division." (R. p. 110.)

"I find that prior to April 6, 1889, no separate accounts were kept of the receipts and disimbursements of the Waco and Northwestern division, but the same was operated as a branch of the general system of the Houston and Texas Central Rail-

way Company, and the evidence fails to show what if any, of the expenditures made by the receivers in causes Nos. 185 and 198, for extraordinary repairs, betterments and improvements and for operating and running expenses were made for said Waco and Northwestern division, and what portion for the other division of said Houston and Texas Central Railway Company; and this is true also as to the receipts and incomes." (R. p. 110.)

"I find that the receivers in cause No. 185, had on hand in cash at the opening of business on January 21, 1886, $175,393.65, but there is no evidence that any part of said fund came into possession of the receivers in this cause." (R. p. 110.)

"I find that the receiver in cause No. 198, had on hand at beginning of business on April 6, 1889, cash amounting to $215,842.45, but the evidence does not show that any part of said funds came into the hands of the receivers in this cause." (R. p. 110.)

The above findings show that the only betterments added to the Waco branch in the long period of time covering over eleven years, was $46,505.40 for betterments and permanent improvements from December 10, 1892, to September 3, 1893, consisting of bridges, shops, and round-houses and car shed, water stations, locomotives, chair car and fencing. The first expenditures for these betterments (December 10, 1892) were made nearly eight years after maturity of petitioner's notes and the last (September, 1895) were made over ten and a half years thereafter. At this time, unless suit had been instituted on the notes they would have been long since barred by limitation, and it could not be held that this fund arising from the operation of the road a decade after the rail were furnished was the current revenue which should have been applied to the payment of petitioner's debt. If this were so there would be no current fund available for the payment of current expenses and the necessary improvements from time to time required to keep the road "a going concern." No Court has ever held that expenditures, so far removed by time, place and circumstance from the claimed current indebtedness to amount to a diversion. But, aside from this, these expenditures were all made under the orders of this Court, in this cause, to which appellants have been parties since 1891. The right to order such expenditures and the necessity therefor has been long since determined by the Circuit Court, and such orders estop and conclude petitioner.

The foregoing argument is based on the assumption that it was found by the master that the interest payment of $91,371.00, in May, 1887, on the Waco & Northwestern division bonds, was made *out of the current revenues of the road.* On this subject the master finds that the accounts were not kept in such a manner as to indicate the exact fund out of which the interest payments were made, and that no separate account was kept of the

earnings of the Waco & Northwestern division as distin guished from the earnings of the other division. And he nowhere finds that this interest was paid out of the income. (See findings R. pp. 110, 114 and 121.) The same is true as to the expenditures for betterments and new equipment. The master finds that the only expenditures made for that purpose on the Waco & Northwestern division was made by Receiver Abeel after December 10, 1892, and prior to September 3, 1895, and amounted to $46,505.40. (R. pp. 109–10.) But there is no finding that these expenditures were made *out of the current income.* The finding is simply that this amount of money was used for that purpose. The burden was on appellant to prove that the expenditures, which it is claimed amounted to a diversion of the current income, were, in fact, made from *that* fund. The findings leave appellant's case without equitable support. For the only real equity relied on by appellant to establish the claimed priority, was the alleged diversion of current income from the payment of supply creditors to the payment of interest on the bonded indebtedness and the erection of permanent improvements upon the mortgaged property.

Appellant would not be entitled to recover on the ground of diversion even if that fact were established, because this rail was sold on the "general credit of the company," was no part of the "current supplies," was part of an "usually large purchase" without any understanding that the rail "should be paid for in any particular way or out of any particular fund" and for virtually reconstructing the road. Besides, the findings show that the rail was furnished twelve to thirteen years ago, and there is nothing in the record to show to what extent, if any, the rail enhanced the value of the mortgage security, or that the road has earned a greater net revenue or sold for a greater price as a result of the placing of this rail in the road. There are no findings whatever on these issues. Appellant is in no position to complain of the sudden action of the Court in appointing receivers in cause 185 in February, 1885, for in a short while thereafter appellant intervened in said suit, joined the Southern Development Company in its prayer for a receiver, and in all things ratified the acts of that company. (R. p. 107.)

Case of Bound vs. Ry. Co., 58th Fed., 473, is in point. In that case this same company, the Lackawanna Iron and Coal Company, intervened on precisely the same character of claim as asserted here for the price of steel rails sold to the Railroad Company on a credit of eight months, and the sale was made eighteen months prior to the appointment of the receiver, and said rails were necessary to the maintenance of the road, and were sold on the promise of the president of the road that they were to be paid for out of the earnings, but this promise was not fulfilled. The notes were extended from time to time, and during the interval before the maturity of the first note $33,000.00 was paid on account of interest due the mortgage bond holders.

It was claimed by intervenor there, as is claimed here, that because its debt was for material which went into the road, improving its condition, and because there had been a diversion of the current debt fund to the payment of interest on mortgage bonds, it was entitled to displace the bond holders to the extent of such interest payment. The claimant prevailed in the lower Court, and the displaced bond holders appealed to the Circuit Court of Appeals. Chief Justice Fuller acting as Circuit Justice, and Judge Hughes and Morris composed the Court, and in passing on and dectding the claim of intervenor there asserted, the Court say: "The rule giving preference to current expenses incurred on the faith of the earnings of a railroad shortly before the appointment of a receiver has never been carried so far. The debt of the Lackawanna Company was an ordinary merchandise debt. The road being heavily mortgaged all that any unsecured creditor had to look to was the earnings. The immediate earnings, it is clear, the Lackawanna Company did not look to, as the sale was on credit of eight months. It must be inferred, therefore, that it was expected that interest on the mortgage debts was meanwhile to be paid during the running of the credit, otherwise a foreclosure would have been imminent within three months after the sale of steel rails was made. The claim is quite different from those ordinary and necessary expenses of operating a railroad contracted but a short time before a receivership, and which by the sudden action of a Court in appointing a receiver, are left unpaid."

To repeat, we believe we have two sufficient answers to this claim of diversion. In the first place, it must be shown that appellants' claim is of the preferential class before they can avail themselves of the doctrine of diversion, or, in other words, claim that there has been a diversion, as we do not understand that a general creditor who is not protected by the peculiar equity which brings his case within the protection of this court is in a position to complain that other creditors have been paid certain amounts on their debts. In the second place it appears from the master's findings that the accounts of the receivership were not kept in a manner so that it can be determined out of what fund this payment of interest was made. On this subject the master finds:

"I further find that the accounts of said railway company were not kept in such a manner as to indicate the exact fund out of which the interest on said first mortgage bonds of the Waco & Northwestern Division were paid, or the exact fund out of which the interest upon the bonds of the other divisions was paid." (R. p. 121.)

As to the erection of betterments on the mortgaged premises, the findings are of the same inconclusive nature. The master nowhere finds that any improvements were erected and paid out of the *income* of the road. He finds on this subject as follows:

"I find that Alfred Abeel, receiver in this cause, has expended under the order of this court, $46,505.40 for betterments and permanent improvements from December 10th, 1892, to September 3rd, 1895, consisting of bridges, shops and roundhouse, car shed, water stations, locomotives, chair car and fencing." (R. p. 110.)

"I find that no part of the income arising from the operation of the road and no part of the proceeds of sales of old iron, old rails, old cars and engines, which was received by the receivers in causes Nos. 185 and 198, ever came into the possession of the receiver in this cause, and the evidence fails to show that any part of the new equipment purchased by the receivers in causes Nos. 185 and 198, as shown above, ever came into the possession of the receivers of this cause. The evidence fails to show that any improvements and betterments of the property added to the property of the Houston & Texas Central Railway Company by the receivers in causes No. 185 and 198, were made on the Waco & Northwestern division." (R. p. 110.)

It will be observed that he does not find that these betterments were paid out of the revenue of the road. The record shows that the mortgage covered a large landed property, aggregating 228,622.28 acres of land besides vendors' lien notes aggregating $107,145.66, still on hand, and which has during all this time been in the hands of the receiver. For aught that appears, the small amount of improvements erected by Abeel, the present receiver, were made out of funds arising from the sale of lands, or collection of land notes covered by the mortgage. In such case no diversion could exist. At least the burden was on appellants not only to allege but to prove a diversion. The Circuit Court of Appeals of the sixth circuit, in the case of Central Trust Co. vs. East Tenn. V. & G. Ry. Co., 80 Fed. at page 626, disposes of a claim that there had been a diversion upon a record substantially similar to the record in this case, and say: (Italics ours.)

"But it is also shown that, during the same period, money was borrowed on open account, more than sufficient to equal the diversion complained of, which went into a common treasury, from which operating expenses, preferential claims, interest, and improvements were paid, without any definite showing as to whether the borrowed money was applied to the payment of interest and improvements, or current income debts. Under this system of bookkeeping, the addition of the borrowed money to the income arising from operation showed a substantial surplus after payment of the great mass of income debts, and all disbursements on account of interest upon the two mortgages foreclosed, as well as upon improvements in the roadway. Prior to the period covered by the maturity of the appellant's claims there was a surplus of gross earnings over all operating expenses; but it cannot be contended that the company was under any obligation to future creditors to accumulate a surplus to meet possible deficiencies in the income to meet future income debts, or that it was improper to apply such surplus in

payment of interest. St. Louis A. & T. H. R. Co. vs. Cleveland C. C. & I. Ry. Co., 125 U. S. 658-675, 8 Sup. Ct. 1011. Whatever diversion there may have been of income to payment of debts or liabilities, not properly debts of the income, seems to have been more than reimbursed by the money borrowed. *The burden is upon complainants to show that there has been a misappropriation of earnings to the improvement of the mortgaged property, or to the payment of interest, before the mortgagees can be justly called upon to reimburse the fund applicable to debts of the income in consequence of such diversion.* If interest was paid or improvements made out of borrowed money, then there was no diversion; or if made out of gross earnings, and the latter was reimbursed by borrowed money, the diversion was made good. The abstracts showing income from all sources and disbursements upon all accounts are somewhat complicated, in consequence of the mode of bookkeeping adopted. The commissioner and court below concurred in reporting that there was no diversion shown. In the absence of very cogent evidence of mistake of fact, or of some error of the law, the finding of fact by the commisioner must be accepted as final. Emil Kiewert Co. vs. Juneau, 24 C. C. A. 294, 78 Fed. 708; Kimberly vs. Arms, 129 U. S. 512-524, 9 Sup. Ct. 355, Tilghman vs. Proctor, 125 U. S. 136, 8 Sup. Ct. 894; Turley vs. Turley, 85 Tenn. 256, 1 S. W. 891."

On what has been said, we are content to leave the case in the hands of this court on the question of diversion.

Fourth Proposition.

Appellants are not entitled to a ratable distribution of the fund in question.

This brings us to the further inquiry; that is, whether appellants have shown that they are entitled to have the decree appealed from reversed and the case sent back so that they may demand pro rata division of the income in the hands of the receiver among all the creditors? This proposition is based on the claim that the mortgage bonds are not secured by a lien on the income after possession was taken. The Circuit Court of Appeals of the fifth circuit, on the same day the opinion was delivered in this case, held in the case of Geo. E. Downs vs Farmers' Loan and Trust Company, et al, that the mortgage in this case did cover the income. (79 Fed. Rep. at page 221.) That case appears to be the conclusion of this question.

There is therefore no warrant for the assumption that no one had a lien on the fund that was used in paying interest on the bonds. For the purposes of this point it may be conceeded that the interest was paid out of current income as claimed by petitioners. The findings of the master show that on February 16th, 1885, the Southern Development Company filed its orignal bill of complaint against the Houston & Texas Central Railway Company in cause No. 185, and that upon this bill receivers,

Clark and Dilingham, were appointed. That on March 31st, 1885, the Farmers' Loan & Trust Company filed its petition in said cause No. 185, praying to be made a party thereto, averring, among other things, that it was trustee under several seprate mortgages executed by defendant railway company, and naming among them the mortgage declared herein. That the prayer of said petition was granted, and on April 6th, 1885, said court entered an order in said cause No. 185, allowing the Farmers' Loan & Trust Company to become a defendant in said suit; and further ordering that it may demur, plead or answer therein on or before the rule day in June, 1885. The record shows that demurrers were filed to the bill of complaint of the Southern Development Company by Easton & Rentool, trustees in one or more of the mortgages executed by defendant railway company, and on May 26th, 1886, these demuraers were in all things sustained, and the entire bill and the supplemental bill of the Southern Development Company was dismissed. Upon the dismissal of these bills in cause No. 185, all the property was transferred to receivers in consolidated cause 198. No other action was thereafter taken in cause 185, but causes 198, 199 and 201 were consolidated, and proceeded to judgment and foreclosure as consolidated cause 198. The consolidation of these causes took place on May 26, 1886, and the causes were filed a few months prior to this. The bills in causes 198, 199 and 201 were bills to foreclose three mortgages given by the Houston & Texas Central railway Company on its railway and properties. One was on the main line, the other on the Austin branch, and third was a general mortgage on the whole system.

Neither the bills of complaint or the mortgages declared on in causes 198, 199 and 201 are in the record, and for that reason it cannot be determined whether these mortgages, in terms, covered the income after possession was taken. But it is clear that at the suit of the trustees in the mortgages declared on in causes 198, 199 and 201, all the property, income, rents and profits of Houston & Texas Central Railway was, on May 26th, 1886, placed in the hands of receivers. By placing the property in the hands of receivers the complaints in those bills made an equitable levy upon the rents and profits to accrue from the operation of the road by the receivers. (Sage vs. Memphis, etc. R'y Co., 125 U. S., 365.) It is very likely the mortgages were drawn in the usual manner of such mortgages, giving a lien on the income after possession is taken. As appellants failed to bring up with the record these mortgages, it may be assumed that if here they would be of value to them. It, therefore, appears with reasonable certainity, that there was a lien on the income of the road and the whole system, after possession was taken at the suit of complainants in causes 198, 199 and 201 on May 26th, 1886, and continously thereafter, and this lien was in favor of the mortgaged bondholders, secured by the mortgages declared on in the above three causes.

The interest payment of $91,371.00 to the bondholders secured by mortgages on the Waco & Northwestern branch so

much complained of, was not made until May 1st, 1887, nearly a year after the receivers appointed in consolidated cause 198 had taken possesion. This fact is perfectly mainfest from the record. Under these circumstances, and while the whole net revenue of the road was under lien to secure the mortgages declared on causes 198, 199 and 201, the complainants in these causes jointly with the trustee in the first mortgageon the Waco & Northwestern branch, applied to the court to have the coupons which matured on January 1st and July 1st, 1885, paid on all the bonds. The prayer of this petition was granted, and the interest was paid on all the first mortgage bonds, and the interest paid to these bondholders amounted to $91,371.00. As it appears that appellants claim is not of the preferred class, and as it further appears that use of the current income for the payment of interest was with the express consent and at the request of the bondholders holding a lien on the very fund used, and who alone could complain, there was certainly no "diversion" of which appellants could complain.

Let us view the matter from another standpoint. Suppose this $91,371.00 was today returned to the receivers in consolidated cause 198, and appellants should apply to have it divided on the principle that equality is equity, and demand a *pro rata* distribution? Would its petition be granted? No. Why?

Because they would be shown that the fund was net income which arose from the operation of the road by the receivers appointed in consolidated cause 198, and that the bondholders either held a lien on this income by the terms of their mortgages after possession was taken, or by the virtue of the equitable levy through the appointment of the receivers, and the whole fund would go to the bondholders in those mortgages, and appellants after the labor and pains of much hard sailing, would be found stranded upon a barren shore, penniless and forelorn. If the bondholders, secured by mortgages declared on in cause 198, chose to invite the bondholders in this cause to participate in a fund to which they had no legal or equitable right, and which belonged to the bondholders in cause 198, that was a matter which could not concern appellants. Appellants were not thereby deprived of a right of any description. Not one dollar of the money paid to the Waco & Northwestern bondholders could have been recovered by petitioners, if the interest had not been paid. In a free fight, under the most favorable conditions, the able counsel for appellants could not hope to successfully engineer this scheme of ratable distribution. It is a bare, naked falacy. It is a delusion. This court will not send this case back to the court below to enable counsel to chase a phantom.

We beg to call attention to the fact that this claim for *pro rata* distribution is an afterthought. No mention of such a claim can be found in appellant's petition of intervention. (R. pp. 75 to 88.) The claim was prosecuted in the lower court upon the demand that appellants were entitled to priority over the bondholders.

The contest was with the bondholders alone. No other party but these two could have an interest in that controversy. But in the doctrine of general equitable distribution now urged, all the creditors must be brought in and a general adjustment take place. This idea was the first time advanced in the Circuit Court of Appeals on page 24 of appellants' brief in that court. It had not been, prior to that time, a matter of any concern to appellants whether the bondholders had a lien or not. They claimed a lien prior and paramount to the best and highest. There is no assignment of error based upon this idea. It is a new tack, based upon the fertile imigination of the able and ingenious counsel who made it, but has no subtantial foundation in any issue in this case.

But suppose it be conceded that the fund used to pay the $91,371.00 interest was not net income, and that nobody had a lien upon or charge against it. This concession aids appellants not in the least. In the first place there is neither pleading or parties before the court to warrant the relief demanded. But the fatal answer to appellants' scheme for equitable distribution, by requiring the boneholders to refund the $91,371.00, and take their share ratably, is that it is nowhere shown that upon the division ~~provision~~ that the bondholders would be ~~entitled~~ entitled to less than they have already gotten. The record shows that the principal of the indebtediness due to these bondholders is over a million dollars. That the bonds bear interest at 7 per cent. per annum. That the only money paid them during a period of over 12 years, from July 1st, 1884, to this date, is the pittance of $91,371.00, and it is solemnly and earenstly demanded that they be required to return that, so that appellents may go back to the lower court and get together all the creditors, find out what each has received on his claim, and have a general division, and this, too, some ten years after the final decree of foreclosure has been entered in consolidated cause 198; the property all sold, and the proceeds distributed to thousands of creditors who are scattered to the four winds of heaven.

But this is not all. If for a moment it ~~we~~ he conceded the appellants ever had the remotest interest in the $91,371.00 paid on the bonds secured by the mortgage foreclosed herein, and had an apparent right to complain of this payment, we beg to call attention to the manner in which the holders of these bonds were treated by the receivers in causes Nos. 185, 198 and 227, until Alfred Abeel was appointed receiver to succeed Mr. Dillingham in December, 1892. Summarized the treatment was this: During the time the entire system of the Houston & Texas Central Railway, which included the Waco branch, was in the hands of receivers from February, 1885, to December, 1892, there was spent in betterments and permanent improvements by the receivers $763,404.03. Not a dollar of this was put on the Waco branch. That branch is about one ninth in mileage of the entire system, and was justly entitled to one ninth of the betterments, which would be $84,823.67. It not

only received no betterments by the receivers, but the old rail taken up by the company from that branch was on hand when the receivers were appointed, and was by them sold for $38,480.00 net. The mortgage, without doubt, covered these rails. The Waco branch is therefore entitled to an equity equal to these two amounts, or the sum of $123,302.67 in the proposed pro rata distribution. These equities are superior to the claim of any unsecured general creditor like appellants. This amount must, therefore, be deducted from the imaginary general fund proposed by appellants and placed to the credit of the Waco branch and it is only the balance left after this deduction is made that will be subject to the demanded equitable pro rata distribution. This amount would be more than sufficient to pay for all the rails laid down on the Waco branch out of the Lackawanna purchases, as the principal of the sum demanded against that branch is only $105,547.15, as this amount does not bear interest. (Thomas vs. Car Co., 149 U. S. 95.)

From this showing, we may reasonably conclude that if the demand of appallants was granted and the case sent back for pro rata distribution, it would avail them nothing.

Fifth Proposition.

Though it may appear that appellants claim on some of the grounds asserted in whole or in part, is entitled to an equitable priority over the mortgage bond holders, such priority will not be decreed in this case, but appellants will be remitted to their intervention in cause No. 198, because (1) it would be inquitable unjust to charge the proceeds arising from the sale of the road —made more than eleven years after the purchase of said supplies—and the net revenues arising from its operation from five to eleven years thereafter, with payment of such debt, and (2) it appears that the receivers in causes Nos. 185 and 198, from February 20, 1885, to April 6, 1889, a period of over four years, immediately after petitioner's debt matured, operated the whole H. & T. C. system, including the Waco branch, took all its revenues and profits during these four years, took 2,960 tons of old iron rail from the Waco branch and disposed of same at a price of $13.00 per ton, aggregating $38,480.00, used the proceeds from the sale of this rail and the revenue of this branch for the purchase of new cars, locomotives and other equipment and the erection of betterments and permanent improvements of the main line and Austin branch, and (3) it appears that this branch during these four years received no betterment or permanent improvements, and the receivers in this cause received no part of the new cars, locomotives and other new equipment purchased by the receivers in causes 185 and 198 and have never come into possession of any of the revenues arising from the operation of said road during the years 1885 to 1889 or the proceeds from the sale of said old iron rail, and because the bond holders secured by the mortgage declared on herein asked no equitable relief in said causes, 185 and 198, and received no part of the proceeds of the sale of the road in said causes.

STATEMENT.

On the subject here discussed, see master's finding No. 16. (R. pp. 109–12.)

On on the subject of receipts and expenditurs of the entire system by the receivers in causes Nos. 185 and 198, the master finds as follows:

"I find that during the receivership of Clark & Dillingham, in said cause No. 185, they received from the operation of the Railway company revenues, and expended for operating expenses, taxes, etc., the following amounts, to-wit:

Amount received from February 23, 1885 to January 21, 1886, two million, seven hundred and fifty-eight thousand, four hundred and eighty-seven and 40-100 dollars	2,758,487.40
Operating expenses, taxes, etc., same period	2,137,322.44
Balance or surplus	621,164.96
Amount received from January 21 to July 10, 1886, one million, one hundred and forty-three thousand, seven hundred and thirty-one and 05-100 dollars	1,143,731.05
For operating expenses, etc., for the same period	1,341,753.85
Leaving a deficit for this period of	$198,022.80
And leaving a net balance from the operation of said railways from February 23,1885, to July 19, 1886, of	$423,142.16

XIX.

"I find that when said Clarke & Dillingham took possession of the property of the defendant railway company on February 23,1885, they received in cash $30,416.34.

That they collected asserts of the company as follows, to-wit:

Traffic balances and other claims	118,730.08
Sales of old rails on hand February 23,1885	110,275.00
Sale of old cars	6,500.00
Total	$265,921.42
Amount expended in paying liabilities of the defendant Railway Company	$23,274.20
Interest paid upon the first mortgage bonds of the company, being interest due January 1, 1885, to July 1, 1885	751,438.15
Amount expended for new steel rails	$245,793.64
Amount expended in payment of certain car trust notes	125,695.44

Amount expended for new passenger coaches, baggage, mail and express cars, etc., and locomotives	265,696.33
Amount expended by said receivers for right of way, fencing, track, real estate, depot, roundhouse, foundry and pattern house at Houston	126,218.62
Total	$1,536,116.38

"I find that the amount expended as above, $384,026.20, was expended under the receivership of Messrs. Clarke & Dillingham."

"The above statement shows receipts and expenditures to January 9, 1888, the date when Master Winter, heard the evidence on this intervention in cause No. 198, but no proof has been offered before me, showing the receipts and disbursements of the receivership in said consolidated cause since said hearing before said master on January 9, 1888."

XXI.

"I find that said Easton and Rintoul and Dillingham during their receivership realized out of proceeds of sale, or collection of old assets of the defendant company, the sum of $135,889.70."

XXII.

"I find that the receivers in cause No. 198 received from the receivers in cause No. 185, the of $138,751.37 in cash."

"I find that the receivers in consolidated cause No. 198, after they took possession of the assets of the Railway Company on July 10, 1886, and up to the time of the filing of the report of master Winter, paid liabilities of the receivers Clark & Dillingham, taxes, outstanding vouchers, pay rolls, traffic balances, $221, 421.32, and collected from the amount due said Clarke & Dillingham as receivers in cause No. 185, $39,-016.69."

The above statement shows that the receivers in cause No. 185 expended for betterments as follows:

Amount expended for new steel rails	$245,793.64
Amount expended in payment of certain car trust notes	135,695.44
Amount expended for new passenger coaches, baggage, mail and express cars and locomotives	265,693.33
Amount expended for right of way, fencing track, real estate, depot, roundhouse, foundry and pattern house at Houston	126,218.03
Making a total of	$763,404.63

This entire amount, $763,404.03, was expended in making betterments and improvements, and the purchase of new equipment, etc., on the main line and Austin branch, and no benefit thereof has ever accrued to the Waco branch. The above amount was undoubtedly paid out of the current revenue of the road, and the Waco branch was entitled to its proportionate share. The findings show that no separate account was kept and in the absence thereof, the only equitable division would be on the mileage basis. The Waco branch is about one-ninth in length of the mileage of the entire system and would be equitably entitled to receive out of the above fund $84,822.67 in betterments and permanent improvements when in fact it received none. In addition to the above statement the findings show that the receivers in cause No. 185 sold 2960 tons of old rail taken from the Waco branch, on which these bond holders had their mortgage, at $13.00 per ton, making an aggregate of $38,480.00. The findings show that no part of this fund has ever come into the hands of the receivers in this cause. This amount added to the above sum of $84,822.67 makes a total of $123,302.67, that has been wrongfully (as against these bond holders) taken from the Waco branch, and used in the erection of improvements upon the main line and Austin branch. The findings show that 6.2 miles of the Waco branch was laid with rails furnished under the first and second contracts, but no proof was introduced showing what proportion was furnished under each. The findings show that all rails furnished under the first and about one half furnished under the second contract were paid for by the Railway Company prior to any receivership over the property. Such being the findings, no amount has been shown to be unpaid to appellants for the 6.2 miles. The findings show further that 30.8 miles of the Waco branch was laid with rails furnished under the third contract, being the 54-pound rail, and that it requires 84.86 tons of said rail to lay a mile of track, which makes 2,613.68 tons of rails to lay 30.8 miles. The purchase price of this rail is $36.60 per ton, making a total of $94,560.68, the original cost price of the total rail unpaid for on the Waco branch. Deducting this amount from the $123,302.67 leaves an excess of $28,741.99 that has been wrongfully taken from the Waco branch and appropriated and used on the main line and Austin branch for permanent improvements and betterments, after fully paying for all steel rails unpaid for on the Waco branch. These figures show that a great wrong has already been committed to the extent of over $28,000.00 and if the fund now in Court should be used in the payment of the 30.8 miles of steel rail another and a greater wrong by far would be committed, but should the receivers in cause No. 198 be required to pay for these rails justice to that extent would be attained.

The foregoing makes it apparent that the appellants should be remitted to their intervention now pending and undetermined in said cause No. 198. The lower court still has juris-

diction over both causes, and entire control of these interventions.

These views were urged upon the attention of the trial Court and it may be that they had the desired influence in the termination of the case. There is no assignment of error covering this feature of the case.

Sixth Proposition.

Appellants allege as one of the grounds of priority that there is a provision in the mortgage declared on allowing the trustee, in case it takes possession of the property under the terms of the mortgage, to pay the floating indebtedness of the company, and that it relied on said provision in selling the rail to the defendant Railway Company. But there is, in fact, no such provision in the mortgage.

STATEMENT.

On this subject the master finds as follows:

"I find in the mortgage given by the Houston and Texas Central Railway Company to the Farmers' Loan and Trust Company, trustee, dated June 16, 1873, being the same mortgage declared on herein, the following provisions:

" 'And in case the said Houston and Texas Central Railway Company shall fail to pay the principal, or any part thereof, or any installment of the interest, or any part thereof, on any of said bonds at any time when the same shall become due and payable according to the tenor thereof and for sixty days after having been demanded, it shall be competent for the said trustee, its successors or assigns, to enter upon the said railway and premises and property herein conveyed, by its attorneys and agents, and take possession of same without let or hindrance of the said first party and every part and parcel thereof, and the appurtenances, and appoint an agent to operate and manage the same, and receive the revenue and income thereof, applying the said funds, after deducting taxes, necessary expenses and counsel fees, to keep the same in good order and repair, and the surplus to pay the principal and interest of all the bonds which may be due and outstanding, and secured hereby, pro rata, and thereafter, to the payment of any contributions due to the sinking fund herein established. And upon the request of the holders of one-fifth in amount of the bonds so in default which may be at any time outstanding under this deed of trust, it shall be the duty of said second party by its president, or agent duly appointed in its behalf, to enter upon and take actual possession, with or without entry, or foreclosure of said railway and property herein described, and all and singular each and every part and parcel thereof, and assume its management until the arrears of both principal and interest be paid, or the property sold, as herein described, re-

ceiving the rents, revenue and income thereof and applying them in the same manner as above stated.

"'It is, however, expressly agreed that the said party of the first part may dispose of the current net revenues and income of all the said property and railway hereby conveyed in such a manner as it shall deem best, until default shall be made in the payment of the interest or principal of said bonds, or of any one or more of them, and shall have the right to sell and dispose of any of such real estate or other property as it may own or acquire, which may not be needed or acquired for the purposes and business of the said Waco and Northwestvrn division, except in the case of the six thousand acres per mile of completed road, and which sale and conveyance of such outside property shall transfer the said property and title free from encumbrance of this mortgage or deed of trust, and to change its tracks and make any and all alterations necessary for the benefit of the same.'

"I find that there is no provision in said mortgage, that the trustee may, if it acquires possession of said railway under said mortgage, pay any floating debt or debts, of said company out of the gross earnings of said railway." (R. pp. 110 to 111.

This suit was filed for the trustees for the mortgage bond holders in the mortgage declared on herein on April 6, 1889, and at the suit of said trustee this Court placed the railroad and other property covered by the mortgage in the hands of a receiver, complainant's bill setting up the above provision contained in the mortgage declared on, claiming a lien on the corpus of the property, and the earnings of the road after the same was placed in the hands of the receiver. Appellants did not intervene in this cause until more than two years after, and and on to-wit: November 3, 1891, simply setting up its priority, and nothing more.

AUTHORITIES.

Dow vs. Memphis & Little Rock R. Co. 124 U. S. p. 652.
(S. C.) 33 Am. & Eng. R. R. Cases, p. 12.
Sage vs. Memphis & Little Rock R. Co., 125 U. S., 361.
(S. C.) 35 Am. & Eng. R. R. Cases, p. 40 and cases therein cited.

Argument.

The merits of appellant's claim for priority is made to rest partly upon the supposed existence of this clause in the mortgage. From this allegation it plainly appears that appellants when selling these rail and extending the time, fully recognized that no superior equity existed over the mortgage, or if any existed it was not relied on. Instead of selling these rail upon the belief that priority would be given upon principles of equity, appellant Lackawanna Company seems to have made the sales with full knowledge of the existence

of the mortgage, and with the understanding that a contract had already been made for its benefit and perfect protection, in that the mortgage contained a clause which required appellant's debt to be paid in any event. This allegation not only shows upon what security appellant relied, but it shows with equal clearness, the *rank* and *character* of appellant's claim. It shows that appellant, in selling the rail and in placing reliance upon this supposed clause understood its claim to be a mere "floating debt," for the supposed clause relied on provides, according to the allegation, for the payment of "floating debts" only. But this particular mortgage contained no such provision. The foundation having failed the superstructure cannot stand. The evidence shows that a number of mortgages given by defendant company were in existence at this time. It is probable that one or all the others contained some such stipulation. Be this as it may, by the allegation above we are given appellant's own version of the rank of its claim, and the security upon which the rail was sold. Having relied on that security no other can now be claimed in the present condition of the record. "The express mention of one thing implies the exclusion of another," is a legal maxim which controls the language of this pleading. We concede that this is not a rule amounting to estopel. The petition could have been amended and a different set of facts alleged, and if true, been proven. But nothing of the kind has occurred. No amendment, no change. The case went before the master and trial court and is brought here claiming and asserting, in the strongest language, that the mortgage contains this clause and that appellant relied on the contract therein made for its benefit in selling the rail, has in all things accepted its terms and conditions, and bases it suit thereon. The allegation makes a case of a lien created by express contract for the benefit of "floating debts," with an unqualified acceptance by appellant. If he relied on this supposed express contract he did not rely on the equity asserted by the assignments of error. But the master finds "that both seller and buyer expected the debts to be paid from the *net* income of the railway." (R. p. 104.) This understanding that the claim was to be paid from the *net* income, as distinguished from the current or gross income, effectually took this claim out of the preferred column and placed it among the general floating indebtedness of the company. This, in connection with the further finding of the master, that the rail was sold on "the general credit of the company," that it "was not a current debt," and that the "purchase was of an unusually large amount of rail," "without any stipulation that security should be given by the defendant company, or that payment therefor should be made out of any particular fund or in any particular way," and for virtually reconstructing the road, taken in connection with the above allegation, that the rail was sold relying upon the supposed terms of the mortgage, rendered the lower courts powerless to prefer appellant's claim.

Seventh Proposition.

Appellants would not be entitled to priority by virtue of the laws of Texas as claimed, because the only law of that state that pretended to give the claimed priority has long since been declared by the Supreme Court of Texas to be unconstitutional.

Giles vs. Stanton, 86 Texas, 620.

Receivers vs. DuBose, 87 Texas. 78.

In conclusion, we beg to quote from a few additional cases on the subjects discussed in this brief. In the case of Blair vs. Ry. Co., 22 Fed. Rep. 474, Mr. Justice Brewer has drawn a clear distinction between sales and supplies made on time voluntarily extended to the road and for stated periods and those made on temporary credit and for current expenses resulting from the peculiar nature of railroad business, affirming that business of such magnitude cannot be transacted on a cash basis, and that in the very nature of this business, *temporary credit* is indispensable. He says:

"The idea which underlies them, I take to be this: That the management of a large business, like a railroad business, cannot be conducted on a cash basis. Temporary credit in the very nature of things is indispensable. Its employes cannot be paid every month. It cannot settle with other roads its traffic balances at the close of every day. Time to adjust and settle these various matters is indispensable. Because in the nature of things this is so, temporary credit must be taken as assented to by the mortgagees, because both the mortgagees and the public are interested in keeping up the road, and having it preserved as a going concern, and whatever is necessary to accomplish this result must be taken as assented to by the mortagees."

In Kneeland vs. Am. Loan Co., 136 U. S., 97 and 98, Mr Justice Brewer used this very forcible language in reference to the character of claims here asserted: "Upon these facts, we remark, first, the appointment of a receiver vests in the Court no absolute control over the property, and no general authority to displace vested contract liens. Because in a few specified and limited cases this court has declared that unsecured claims were entitled to priority over mortgaged debts, an idea seems to have obtained that a Court appointing a receiver acqires power to give such preference to any general and unsecured claims. It has been assumed that a Court appointing a receiver could rightfully burden the mortgaged property for the payment of an unsecured indebtedness. Indeed, we are advised that some Courts have made the appointment of a receiver conditional upon the payment of all unsecured indebtedness in preference to the mortgage liens sought to be enforced. Can anything be conceived which more thoroughly destroys the sacredness of contract obligations? One holding a mortgage debt upon a railroad has the same right to demand and expect

of the Court respect for his vested and contracted priority as the holders of a mortgage lien on a farm or lot, so, when a Court appoints a receiver of railroad property, it has no right to make that receivership conditional on the payment of other than those few unsecured claims which, by the ruling of this Court, have been declared to have an equitable priority. No one is bound to sell to a railroad company, or to work for it, and whoever has dealings with a company whose property is mortgaged must be assumed to have dealt with it on the faith of its personal responsibility, and not in the expectation of subsequently displacing the priority of the mortgage liens. It is the exception, and not the rule, that such priority liens can be displaced. We emphasize this fact of the sacredness of contract liens, for the reason that there seems to be growing an idea that the chancellor in the exercise of his equitable powers, has unlimited discretion in this matter of the displacement of vested liens. Railroad Co. vs. Railroad Co., 125 U. S., 658, 673. So that these intervenors acquire no right of priority by virture of their antecedent contracts of sale."

To the authorities cited above, we add the following:

1. On the question of allowing back debts of longer standing than six months:

20 Am. & Eng. Ency. of Law, p. 425 and cases cited.
Blair vs. Ry. Co., 22 Fed. Rep., p. 471.
In re Kelley, 5 Fed. Rep., p. 846.

On the question of the propriety of a Court of equity to give claims of the character herein asserted priority over a prior mortgage:

Forman vs. Central Trust Co., 71 Fed. Rep., p. 776.
Railway Company vs. Cowdy, 11 Wall, 482.
Central Trust Co. vs. Chattanooga Ry. Co., 69 Fed. Rep., 295.
Thompson vs. Valley Ry. Co., 132 U. S., 68.
Farmers & Merchants Nat. Bk. vs. Ry. Co., 36 S. W. R., 131.
Toledo Ry. Co. vs. Hamilton, 134 U. S., 296.
Trustees vs. Ry. Co., 2 Wood, 542.
Denison vs. Ry., Co., 4 Biss, 416.
High on Receivers, Sec. 394a.
Express Co. vs. Ry. Co., 99 U. S., 191.
Turner vs. Ry. Co., 8 Biss, 315.
Miltenberger vs. Ry. Co., 106 U. S., 286.
Trust Co., vs. Souter, 107 U. S., 591.
Burnham vs. Bowen, 111 U. S., 776.
L. C. & N. Co. vs. Ry. Co., 29 N. J., Eq., 252.
In re Kelley, 5 Fed. Rep., 846.
Bridge Co. vs. Douglas, 12 Bush, 673.

We submit with confidence, that appellants have not shown that they are entitled to priority of payment, either out of the proceeds of sale or net income arising from the operation of the road, or that there is error in the degree appealed from and we request that it be affirmed.

The foregoing brief together with what we say in our briefs filed in the circuit court of appeals—copies of which are filed in this court—sufficiently presents our views of the facts of the case and the law arising theron. We therefore pass to the consideration of another proposition—,namely. That appellant's petition for priority must in the end be denied because if the claim ever belonged to the preferential class it has long since been paid off, merged and extinquished by the terms of the purchase. All the facts bearing upon this point are not in this record proper and the point is presented and asked be considered only in the event this court should conclude that appellants are entitled to priority in the payment of their claim over the bond holders and then only as grounds for reversing and remanding instead of revising with directions to render. We are quite sincere when we say we have no fears of such a result we feel it not out of place to call attention to the facts as they have been unfolded and brought to light in the many branches of litigation which have grown out of the main case in which appellants intervened and prosecuted their claim for priority. We will not burden this court with a long and tedious statement. Suffice it to say that there has been two sales of the railway properties held by the court through its receivers. The first was a foreclosure sale under a junior mortgage and the last a foreclosure sale under the first mortgage. At the first sale one Geo. E. Downs became the nominal purchaser, and at the second, Wilber F. Boyle became the nominal purchaser, but both purchases were in fact made for the appellant Pacific Improvement Company, the owner of the Lackawanna claim. By the terms of the final decrees under which both sales were made the purchaser was in terms required to pay the Lackawanna claim. The facts as to who were the real purchasers at said sales have come to light since this case was decided by the Circut Court of Appeals. But the facts are quite clear and the Circuit Court of Appeals in deciding several appeals taken out of the main case since this appeal have recently held that the appellant Pacific Improvment Company as a part of their purchase and in addition to the sum bid, agreed to pay the Lackawanna claim—the very claim being prosecuted in this court by the Pacific Improvement Company for priority over the mortgage bondholders. On this subject that court say:

"The record shows that the Pacific Improvement Company is the real party in interest represented in these several appeals, that Company being the purchaser represented by Wilbur F. Boyle, and the owner of the 614 bonds, which said Boyle represents, and the owner of the Lackawanna claim, set up as a lien prior to that of the first mortgage bonds; that the purchaser at the sale under the decree, and as a part of the consideration, and in addition to the sum bid, took the property upon the express condition that he would pay and satisfy, among others, the Lackawanna claim; that the reservation of the sum of $187,000, out of the earnings of the road to await the decision

of the Supreme Court of the Lackawanna claim is in the direct interest of the appellants." 88 Fed. Rep. p. 930.

If it be true that appellant Pacific Improvement Co. has agreed to pay off and discharge this Lackawanna claim, said company being at the same time the owner of the claim, that extinguishes the claim and in no event can appellants hope to prevail in this case. These facts having come to light since the decision of this case in the courts below we knew of no way of getting that fact before this court as an answer to the merits. But for the purposes desired we have no doubt this court has the right to consider that fact and to examine the opinion of Circuit Court of Appeals and the record upon which it is based. And so we cite the court to the opinion and have filed with the clerk of this court for the use of this court and opposing counsel several copies of the printed record used in the Circuit Court of Appeals. And call attention to the depositions of Thos. H. Hubbard, Geo. E. Downs, ~~E. E. Gates~~ and Wilbur F. Boyle copied in said record pages *489 to 505 and* to *the* petition of Pacific Improvment Company to reserve fund in court, page *450 and 451* which show the facts very clearly that the Pacific Improvement Company the appellant here is the purchaser at the foreclosure sale and the decree in the record proper shows that the purchaser assumed the payment of that claim. (R. p. 40, 41.)

This brief reference to said case and record is sufficient to put this court upon notice of the facts as subsequently developed so as to shape its decree in case that should become necessary to give these appellees an opportunity to protect themselves against said claim.

Respectfully submitted,

L. W. CAMPBELL,

Solicitor for appellees, Moran Bros. and Henry K. McHarg.

No. 22.

Brief of Turner & Mott for Appellee

SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1898.

Filed Mar. 4, 1899.

NO. 182.

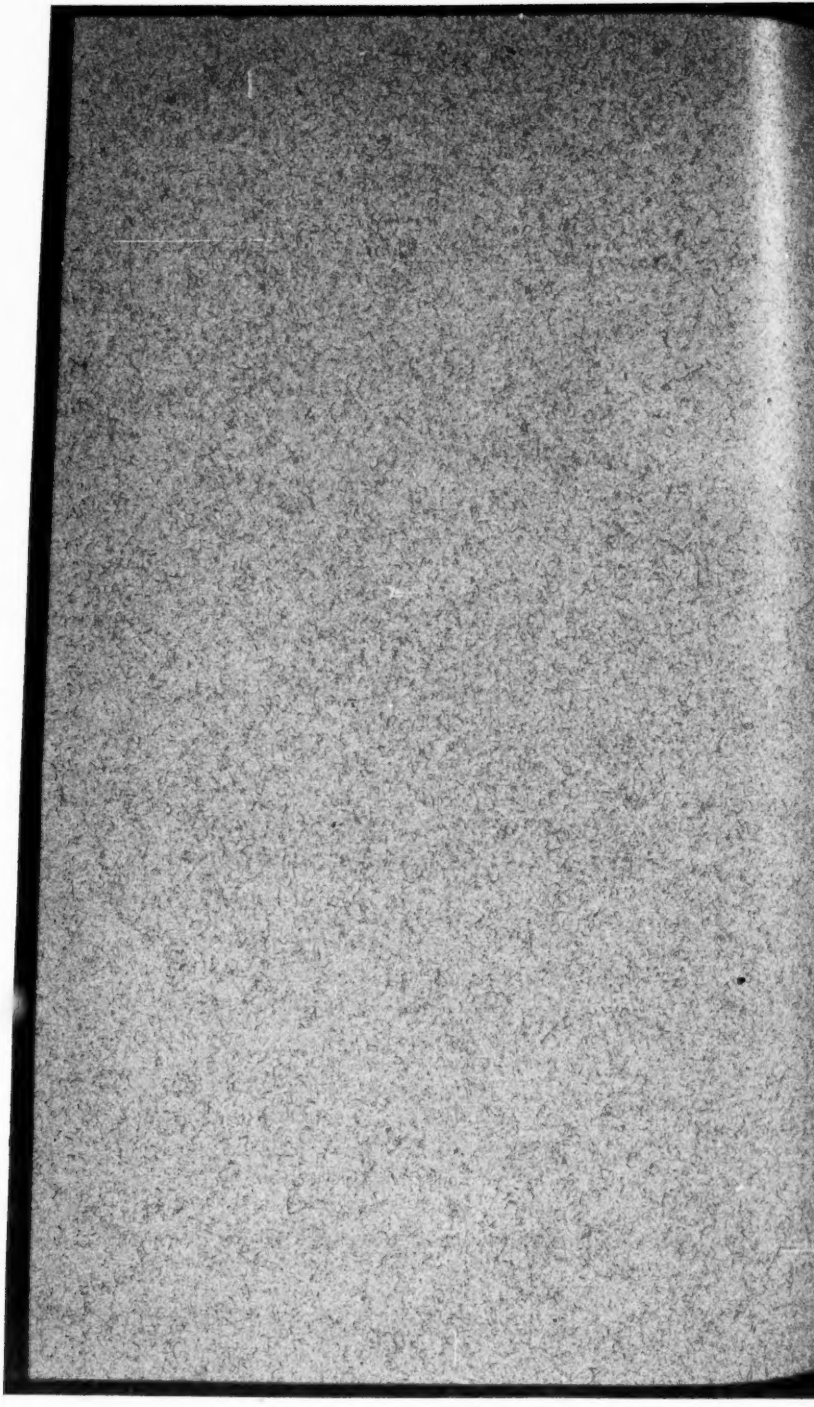
THE LACKAWANNA IRON AND COAL COMPANY, *et al.*,
Intervenors and Appellants,

vs.

THE FARMERS' LOAN AND TRUST COMPANY,
Complainant-Respondent.

SUPPLEMENTAL BRIEF FOR THE FARMERS' LOAN AND TRUST COMPANY.

HERBERT B. TURNER,
M. F. MOTT,
Solicitors and of Counsel for
THE FARMERS' LOAN AND TRUST COMPANY.



SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1898.

THE LACKAWANNA IRON AND COAL COMPANY, *et al.*, Intervenors and Appellants, *vs.* THE FARMERS' LOAN AND TRUST COMPANY, Complainant-Respondent.	No. 162.

Supplemental Brief for the Farmers' Loan and Trust Company, Respondent.

In view of the very elaborate Brief, of nearly one hundred pages, submitted by the Appellants, we will ask the Court to permit us to file this memorandum in reply.

The matter, as submitted to the Court by the appellants, is, unfortunately, largely complicated with the entire Houston and Texas Central litigation. Many facts are set up by them which hardly seem to us pertinent to the issues now before the Court. Indeed, the questions here are very simple, as the Court will see by examining our original brief filed in this cause.

The appellants state in the second paragraph on

page 2 of their brief, that default was made by the Railway Company on January 1st, 1885, in the payment of interest on its "First Mortgage Bonds." This fact was found by the Master (page 105 of the Record) in this form. But care must be taken to distinguish between the several classes of bonds referred to here as "First Mortgage Bonds." That description, as used by the Master, includes the First Mortgage Main Line bonds, amounting to $6,262,000; the First Mortgage Western Division bonds amounting to $2,270,000; and the *First Mortgage Waco and Northwestern Division* bonds amounting to only $1,140,000. We are concerned solely with the last-mentioned bonds, the default on which, on January 1st, 1885, amounted to only $39,900, the semi-annual interest due that day, out of a total of $333,760 then defaulted by the Railway Company (Rec. p. 105). The Waco and Northwestern division was but a small portion —but 11 $\frac{13}{100}$ per cent.—of the Houston and Texas Central System—being only 58 miles long as against 520 miles for the whole system. This comparison should be remembered when considering the matters mentioned in the Appellants' Brief and the dealings of the Receivers, who were receiving and disbursing the moneys of the entire road and managing its general affairs regardless of its divisions. They did not even keep separate accounts for the divisions (Rec. p. 110), and it is impossible to tell, as the Master himself finds (Rec., p. 110) "what, if any, of the expenditures made by the Receivers in causes Nos. 185 and 198 for extraordinary repairs, betterments and improvements, and for operating and running expenses, were made for said Waco and Northwestern division, * * * and this is true also as to *receipts* and *incomes*."

Now, let us see what the situation was when, for the first time on January 1st, 1885, default was made in first mortgage coupons, including those due under the Waco and Northwestern Division mortgage. Before that date, it will be admitted, the holders of that mortgage had no power to take any action whatever with regard to the mortgaged property, nor indeed did the mortgage permit them to act until 60 days after demand, based on such default (Rec., p. 15). We wish to call the Court's attention to the events which had already become *fixed and settled facts* when the first default on our mortgage occurred, and during a period when we were helpless, by the terms of the mortgage itself, to control in any way the actions of the railway company.

(*a.*) The three contracts for steel rails referred to in the petition had been made by the Railway Company with the Lackawanna Company on December 28th, 1882. April 26th, 1883, and October 30th, 1883, respectively (Rec., pp. 99–102). With the two first contracts and the rails delivered under them, we are not concerned. The petitioners abandon any claim as to them (Brief on behalf of Petitioners, p. 5). The only contract to be considered by the Court is that of October 30th, 1883, made *one year and two months* prior to any default in payment of interest.

(*b.*) The period limited in this last mentioned contract for the delivery of the 10,000 tons of steel rails called for by it had expired, that period being between February 1st and August 1st, 1884 (Rec., p. 102).

(*c.*) The total actual delivery of rails under this contract, amounting to 8,552 tons had been

made in the months of *February, March, April and May of 1884*, that is to say, such delivery had been completed and the last rail delivered *seven months* before any default in the payment of interest (Record, p. 102).

(*d.*) The time for the payment of the purchase price for all these rails—which, under the contract was to be made either *in cash on delivery* or in *six months'* notes of the railway company dating from the average date of *delivery*, with a privilege in the Railway Company to renew such notes before their maturity for a further term of six months—had matured in the following manner: The company had given notes instead of cash for all the rails, which, if made in accordance with the contract and collected when due instead of being extended, would all have matured finally by the first day of December, 1884 (Rec. pp. 102, 103). But the Lackawanna Company "for the accommodation and to suit the convenience" of the Railway Company, had voluntarily given the latter in the contract the privilege of extending the notes, so that the last of them *as so extended* did not fall due until May 18th, 1885 (Rec. pp. 103). The amount of the notes due at this date (May 18th, 1885) was $327,175.50—being the *total* balance of principal due for the rails delivered under the contract with which we are concerned (Rec., p. 103). Of this amount, only $99,300.64 is claimed by the appellant to have gone into the Waco and Northwestern Division, that division, as has already been pointed out, being only 58 miles out of a total of 520 miles for the whole system, and of those 58 miles only 30.8 being laid with the

rails in question (Rec., p. 104, and Petitioner's Brief, pp. 5-6).

(*e.*) All the rails delivered to the Railway Company by the appellants had been placed in the Railway Company's tracks immediately on delivery and, therefore, long before any receivership or default on the Waco and Northwestern Division Mortgage (Rec. p. 105).

In view of these facts, what becomes of the appellants' argument, based on the theory that the appellee's alleged delay in *taking possession* had constituted the Railway Company its *agent* to operate the road and to make expenditures for its protection, including this expenditure for steel rails, with the understanding that such expenditures would create a first lien on the property, prior to the mortgage? This argument runs all through their brief, in the Statement of Facts as well as in the Points of Law. On page 22 we find the proposition that "the mortgagee, by leaving the mortgagor in charge of the mortgaged property, makes him his agent to create any lien necessary and proper to save and preserve the property and keep it a 'going concern.'" On page 39 we find the proposition that "the mortgage creditors, by leaving the railway company in possession of the property, impliedly authorized it to create any liens thereon which might be necessary to keep up the property, and enable it to continue to earn the interest upon the mortgaged debt." The discussion of this proposition extends from page 39 to page 48, and a number of authorities are cited which, as we shall point out, do not even sustain that proposition as a naked theorem. The italics on pages 50, 53, 54, 56 and 57 are

all inserted with a view to supporting the same argument, and a very important part of the appellants' contention will be destroyed by showing (1) the fallacy of the argument itself, and (2) its inapplicability to this case even if it were otherwise valid.

Before discussing these two points, however, we will add a few words as to another argument in this connection which, it begins to dawn on us, is now being urged by the appellants. We mean the argument that a trustee, *by the very act of accepting* a Railroad trust-deed, and not taking possession of the railroad immediately *upon the execution* of the instrument, is thereby to be considered as authorizing the railroad company to act as its *agent* and to create liens superior to the mortgage for whatever expenditures may be deemed *necessary* to the preservation of the property! In other words, it is now argued that the mortgage is not the first lien it purports to be because the trustee did not do something which by the terms of the mortgage itself, and in the nature of things, it could not do—namely, take possession of the property and run the railroad at once.

The First and Second Points (Brief, pages 20 to 48) show clearly that this theory is in the minds of appellants' counsel. Yet we feel safe in saying that no such extraordinary doctrine has ever before been advanced in a railroad mortgage case. From the number of instances of *chattel mortgages* cited by the appellants, we should infer that their doctrine is designed as an extension of certain propositions concerning *individual chattel* mortgages with or without possession which they assume to be law. And this inference is strengthened by the remarks on page 48 of the appellants' brief, in which they seek to show that there is no difference in the rules

applicable to ordinary individual mortgages on specific things, and those applicable to mortgages upon vast systems of corporate property. But, assuming that the propositions advanced by the appellants were true as regards private mortgages (which we very much doubt), they themselves point out, on the same page, that this Court has declared railroad mortgages to be "peculiar in their character" (*Fosdick* vs. *Schall*, 99 U. S., 235.) They point out at the same place that this Court has refused to apply the principles which govern in railroad cases even to cases of other *corporate* enterprises (*Wood* vs. *Guarantee Trust Co.*, 128 U. S., 416, 421.) They say that railroad mortgages are not *sui generis*. But this Court has said that they are, and, in the nature of things, they must be.

"There is a broad distinction" said this Court in the *Wood* case, above cited, "between such a case and that of a purely private concern." And the Court, in that decision, was declining to extend the doctrine of *Fosdick* vs. *Schall*, to cases other than railroad cases, thus showing that one of the important distinctions between private mortgages and railroad mortgages lies in the very matter now before the Court.

In *Shaw* vs. *Railroad Co*., (100 U. S., 613,) this Court said distinctly: "Railroad mortgages are a peculiar class of securities."

But it would seem unnecessary to remind the Court further of its allusions to this manifest fact. To argue that unless the trustee takes possession immediately on the making of the mortgage its lien is liable to be divested by the railway company acting as its agent in certain respects is to make a different contract from that which the mortgage makes. The *mortgage* expressly preserves the railroad company from all interference by the trustee as long as the interest is paid.

For what object is a railroad company organized if not to operate its railroad? Did anybody ever hear of a Trust Company's taking hold of a railroad as soon as the mortgage was made and operating the road while the railroad did nothing? It is a matter of common knowledge that in most instances one of the first acts of a railroad company after organization is to issue bonds and to make a mortgage securing them. The reason is obvious. Such bonds are necessary to fund the enterprise and, generally, to build the railroad. What folly, then, to suppose that a case could ever arise where a railroad trustee might, *under the terms of the mortgage*, take instant possession of the property and thus deprive the railroad company of the one purpose for which it came into existence! This reflection shows the cardinal distinction between railroad and private mortgages. And, since it is inconceivable that the trustee should ever take possession *instanter under the mortgage*, the proposition of the appellants, if it means anything, must mean that Railroad Companies *are not able*—that is, are not permitted by law—to make first mortgages which they may not afterwards displace by means of new liens. It is said that these new liens must be for *necessary* expenditures. But who shall determine what are *necessary* expenditures? Perhaps, in order to keep the road a "going concern" it would be *necessary* to make another mortgage, and, in that case, according to the appellants' argument, the *second* mortgage would be the *first* lien! This, indeed, is the proposition towards which the appellants gravitate—a proposition known to no law except the law of admiralty where the latest service is held entitled to the first lien.

The appellants cite a number of *admiralty* cases

where this doctrine is undoubtedly applied. But this Court has held over and over again, on such applications as the present, that the cited doctrine of admiralty law does not apply to railroads. (*Galveston* vs. *Cowdrey*, 11 Wall., 459, 482; *Thompson* vs. *Valley R. R. Co.*, 132 U. S., 68; *Fogg* vs. *Blair*, 133 U. S., 534; *Toledo R. R. Co.* vs. *Hamilton*, 134 U. S., 296. And see also the able opinion of Judge Manning in *Meyer* vs. *Johnston*, 53 Ala., 237).

But perhaps we mis-read the appellants' argument, and perhaps they intend after all only to contend, as has so often been done in this class of cases, that the claims of the Lackawanna Company were in some way improved as against the bondholders by the trustee's failure to take possession or to bring suit immediately upon the maturing of its right to do so under the terms of the mortgage. As already pointed out, that right matured sixty days after demand based upon the default of January 1st, 1885. We will, therefore, consider this argument under the two heads already indicated on page 5 of this brief:

1.—The argument is fallacious in itself.

This subject has been shortly discussed in our original brief (pages 26–28). But in view of the reliance which the appellants seem to place upon this phase of the case, we will here expand a little the ideas suggested there.

In some of this Court's decisions on the so-called "back-claims," expressions are found calling attention to the delay of mortgagees to take possession, and intimating that such delay may be an element in a general situation *estopping* the mortgagees from insisting on the pri-

ority of their lien. Some of these expressions are quoted by the appellants (Brief, pages 50, 53, 56, and 57). But a reference to those cases will show that they have no such effect as is attributed to them; that the matter of delay in taking possession was only a minor element in the numerous elements of decision; that in so far as it was an element at all, the Court's argument was largely a corollary of the undisputed principle that railroad mortgages cover only *beneficial* income after deducting *current operating expenses* (the Master has emphatically held that the appellants' claim is not a current operating expense, Rec., p. 104); and that the logic of the Court ran thus: The trustees could, if they saw fit, be in possession; if they were in possession, their lien would only attach to *beneficial* earnings after the payment of operating expenses; such operating expenses would necessarily be incurred in keeping the road a going concern; it is reasonable to assume, under such circumstance, a consent on their part to the incurring by the railroad of operating expenses, payable out of the earnings; and, therefore, when the earnings have been applied, not to the payment of these expenses, but for the benefit of bondholders, it is equitable to require a restoration of them out of the receivership income. The meaning of this is readily perceived. Clearly, it does not rest upon any doctrine of implied *agency*. The extent of the claims to be allowed, the limit of time during which they may be incurred, and the conditions under which an implied consent can be raised from delay, must necessarily depend upon the peculiar circumstances of each case. The *sine qua non* is that the *claims* should be ordinary operating expenses; that they should have arisen *after* the trustees were in a position to take or demand possession; and that earnings which the *railroad company* should have applied to the payment of the claims

were, during the period of the trustees' neglect, paid to or for the benefit of the bondholders.

These principles are made clear by the decisions of this Court cited by the appellants. Take, for instance, the *Morrison* case, quoted by them on pages 50–51 of their brief. In that case, the default having taken place in October, 1873, and the trustees having neglected to take possession, over a year later one Morrison went as surety on a bond for the Railroad Company to stay the execution of a judgment against it. In 1877, the Court decided against the Railroad Company on the bond and the surety became liable. Not until after all this had happened did the trustees see fit to institute foreclosure proceedings. Thus, Morrison's claim against the railroad company for indemnity because of his liability as surety on its behalf, had arisen and matured *during* the open neglect of the trustees to enforce an already existing default. And it was with reference to that neglect that this Court used the language quoted by the appellants. The crucial point was that the trustees, being in a position to seize the property, wilfully "allowed the railroad company to continue to use the property, and to take care of it for them, and stood by and saw Morrison (who had no interest in the matter) put his hands into the fire and rescue the rolling stock of which they were to receive the benefit." But even this would probably not have been sufficient to sway the decision in favor of Morrison, but for a multitude of other circumstances, all of which the Court considered in a very long opinion, calling the case "a special one."

Burnham vs. *Bowen*, (111 U. S., 776,) also quoted by the appellants at page 53 of their brief, proceeds on precisely the same grounds. In that case the mortgage having been made in 1871, no interest was ever paid, and the trustees might then and

there have taken possession. Instead of doing so, they allowed the Railroad Company to continue in possession for over four years. *During this period of neglect* Bowen furnished coal to the Railroad Company, which failed to pay for it, and applied all the current income to improving the bondholders' lien by paying off prior encumbrances on the property. Under these circumstances, this Court authorized the payment of Bowen's coal bill prior to the bonds. His claim was a current operating expense. It arose and matured during the trustee's neglect. The current earnings concededly applicable to the payment of such expenses were used for the benefit of the mortgagee.

"We do not now hold," said the Court, "any more than we did in *Fosdick* vs. *Schall*, or *Huidekoper* vs. *Locomotive Works*, 99 U. S., 258, 260, that the income of a railroad in the hands of a Receiver, for the benefit of mortgage creditors who have a lien upon it under their mortgage, can be taken away from them and used to pay the general creditors of the road. *All we then decided, and all we now decide, is, that if current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use.*"

In *Union Trust Co.* vs. *Souther*, (107 U. S., 591,) quoted by the appellants on pages 56 and 57 of their brief, the same principles governed the Court's decision. In that case, besides the elements existing in the cases already cited, there was an actual express *consent* on the part of the trustee from which an estoppel against it in favor of the claimant could readily be deduced. Default had been made as early as 1873. The complainant's bill was not filed until 1877. The Court had made an order requiring the Receiver, after paying current expenses, etc., to pay labor and supply

debts that accrued within the six preceding months. During the receivership the net earnings exceeded $200,000. The whole amount, under the orders of the Court, *and with the consent of the complainant*, was from time to time expended in purchasing additional rolling stock, etc., and making permanent improvements, instead of discharging the claims under the six months' rule aforesaid. The property so acquired was sold with the rest under the mortgage, and the sale left a balance of mortgage debt unsatisfied. The intervenor had proved a claim under the six months' rule for $500, and he claimed payment of this claim out of the proceeds of the sale. It seems a plain case. The claim was sustained of course. In a long opinion reviewing all the facts and many authorities the Court used the language quoted by the appellants. The meaning of that language in view of the above facts is very evident and further illustrates the principles which govern in such cases, as we have set them forth in this brief. Nothing could be clearer than that there was no intention on the part of the Court in those cases to establish a doctrine that by a delay in taking possession after default the trustee makes the railroad company or anybody else its *agent* to incur debts.

No such interpretation can be placed on the language of the Court.

In the *Matter of the Dexterville M'f'g & Boom Co.* vs. *Case* (4 Fed. Rep., 873), an attempt was made to obtain a preference for a claim of damages to property by fire from a locomotive. After citing *Hale* vs. *Frost*, the Court said:

"To sustain the claims in question, it is, therefore, necessary that some equity be found in favor of the petitioners, and superior to that of the bondholders upon which to base their allowance. And the supposed equity urged is that the

fire in question occurred after default on the part of the railroad company in payment of the mortgage debt or interest; that thereafter the company operated the road as the agent or trustee in equity of the bondholders, and that the alleged liability sought to be enforced in the present proceeding arose from such operation of the road and as an incident thereto; that, therefore, it may be put under the head of operating expenses. * * * No relation of principal and agent, either in law or equity, can be implied from the mere fact that the railroad company continued to operate the road after it was in default in payment of the mortgage debt, nor from the further fact that the bondholders did not take possession of the property after such default, nor from both facts combined. * * The negligence of the company, if there was negligence at all, occasioned the loss. For that negligence it alone was responsible. To sustain the position taken by the petitioners, it must be held that the bondholders at least impliedly assumed liability for the negligence of the railroad company. * * * I cannot so hold. * * * In no just or proper sense could such claims as these be considered as part of the operating expenses upon which the petitioners could assert a right prior to that of the mortgagees. They are wholly unlike claims for supplies, new equipment, right of way, and new construction, or any claim falling legitimately under the head of operating expenses.* * * It is not improper to add that this ruling is supported by the practice of the learned Circuit Judge of this circuit." (Seventh Circuit.)

In *Blair* vs. *St. Louis H. & K. Co.* (22 Fed. Rep., 471), Mr. Justice BREWER made the following significant remarks:

"What claims are entitled to such equitable preference? The master has reported in favor of all claims accruing since the default in payment of the interest on the mortgage debt—a period of over two years. This seems to proceed upon the assumption that the mortgagees, by failing to take action, have made the mortgagor company their agent to incur debts; have impliedly consented

that all such debts should take preference of their secured claims. I do not think that this principle is sound. There is no implied agency to that extent, and I do not think that the rulings of the Supreme Court are based upon any such doctrine. The idea which underlies them I take to be this: that the management of a large business, like that of a railroad company, cannot be conducted on a cash basis. Temporary credit, in the nature of things, is indispensable. Its employes cannot be paid every month. It cannot settle with other roads its traffic balances at the close of every day. Time to adjust and settle these various matters is indispensable; because, in the nature of things, this is so, such temporary credits must be taken as assented to by the mortgagees, because both the mortgagees and the public are interested in keeping up the road, and having it preserved as a going concern, and whatever is necessary to accomplish this result must be taken as assented to by the mortgagees. In this view, such temporary credits accruing prior to the appointment of the Receiver must be recognized by the mortgagees, and such claims preferred. Now, for what time prior to the appointment of a Receiver may these credits be sustained? There is no arbitrary time prescribed, and it should be only such reasonable time as, in the nature of things and in the ordinary course of business, would be sufficient to have such claims settled and paid."

In the same case, upon another intervention (22 Fed. Rep., 769), TREAT, J., referring to the opinion of Judge Brewer, said:

"In this case, Judge Brewer, reviewing the authorities, cursorily intimated that demands which had accrued within six months prior to the appointment of a receiver, if they pertained to betterments, or the current necessary operations of the road, should be considered as equitable demands prior in right to the mortgage. There are two propositions underlying the rulings of the Courts: *First*, When, under the conditions of a mortgage, the mortgagee, after default, permits the corporation to still operate the road, the operations

thereafter must be considered for the benefit of the mortgagee and all others in interest, especially if betterments accrue therefrom. *Second*, To prevent the indefinite extension of such claims, the Courts limit the time within which such demands may be pursued * * *

"The mortgagee could have taken possession of the road under default, had he so elected. He preferred that the corporation should still continue to operate the road, certainly as much for his benefit as that of other parties. Why, then, as after-acquired property is to be included within his mortgage, should he not deal with said betterments according to equitable rules? True, there should be, as stated by Judge Brewer, some limit to the enforcement of such alleged obligations—fixed in this case at six months."

On a motion for a re-hearing of the above intervention (23 Fed. Rep., 704), Judge BREWER was again called upon to discuss this question. He said:

"Some criticism was made in the argument on what was said by brother Treat as to the mortgagor being agent of the mortgagee after default in the payment of interest. I do not think my brother Treat meant to be understood as laying down as a general proposition that wherever there was default the mortgagor became the general agent for the mortgagee for the contraction of debt. Certainly, if he did, I should not feel like agreeing with that view."

In the case of *Dow* vs. *Railroad Company* (20 Fed. Rep., 260), Judge CALDWELL had used the following argument to sustain a sweeping order appointing a Receiver:

"The first clause is proper, because it has been opened to the plaintiffs to apply for and obtain the relief they now seek, for more than a year, and by permitting the company to run and operate the road, they must, as between them and the persons furnishing labor, supplies and materials for the use of the road, and those damaged by its operation

be held to have impliedly assented that the earnings of the road should be applied to pay such expenses and liabilities which, in a greater or less degree, were incurred for the plaintiffs' benefit."

Commenting on this argument, Judge JENKINS in the case of the *Farmers' Loan and Trust Co.* vs. *Green Bay, W. & St. P. Ry. Co.* (45 Fed. Rep., 664), said:

"A careful reading of all decisions of the supreme tribunal upon that subject convinces me that Judge Caldwell has either misconceived the underlying principle of these decisions, or seeks to extend it unduly.

"The Supreme Court, as I read the opinions, has been most careful to limit the doctrine to claims representing that which has inured to the benefit of the mortgaged property, such as labor and supply claims, amounts due to connecting roads for materials, repairs, ticket and freight balances, and the like, allowing priority to such claims, because their non-payment would cause cessation of work, supplies, and running arrangements, and result in stoppage in the operation of the road, which, in the interest, as well of the bondholder as of the public, is not to be tolerated. * * * * If failure to take possession works an implied assent that the earnings should be applied in compensation of casualties in priority to the mortgage, why not as to all floating indebtedness, to all improvements upon the road, and irrespective of time? Why not say that, through failure to take possession, the bondholders assent that earnings should be devoted to the payment of all debts incurred after default in the payment of interest, and in priority thereto? Why limit such priority to the period of six months prior to the receivership? If priority is to be predicated upon implied assent instead of upon benefit to the *res*, it should be allowed to all claims arising during failure to take possession from which assent is implied. The priority should be co-extensive in point of time with the implied assent. That logically results from the principle bottomed upon implied assent. Such doctrine is, to my thinking, a broad

departure from the equitable doctrine declared by the Supreme Court, and would be ruinous in its consequences. If conceded, the entire floating debt of a railway company, occurring after default in payment of interest, and during failure to take possession, would necessarily and logically be given priority. Vested rights of property would be subjected to great detriment under such holding. The bonds of American railways are scattered throughout Europe, and are held in many hands. It requires much time to institute concerted action by the holders after default in payment of interest. Meantime, unprincipled directors, anxious to retain possession of the road, could contract indebtedness—given priority by such ruling—working ruin to the mortgage interest. The bondholder would be 'improved out of his estate,' and his vested rights placed at the mercy of hostile directors. I am unwilling to assent to such doctrine. I do not understand it to be the law. The rule is that current income should be first devoted to the current expenses of operation. Liability for death is not an expense of operation in any just sense of the term. It is an unsecured debt, and as such, cannot take precedence in payment over prior and express liens. *St. Louis, etc., R. R. Co.* vs. *Cleveland, etc., Ry. Co.*, 125 U. S. 658, 673, 8 Sup. Ct. Rep., 1011."

This strong opinion shows the care which Courts should exercise in spelling out an estoppel from the acts of bondholders. Consent can only be implied where the reason of the case requires it. Ancient claims do not acquire a right to priority simply because they arose after a default in payment of bonded indebtedness. Delay in taking possession after default may, under some circumstances, become an element in estopping mortgagees from claiming their prior lien, but it cannot be made use of to resuscitate old claims, to load the property with burdens, and to relieve claimants from the consequence of their own neglect to collect their claims from the railroad company within a reasonable period.

"It has never been decided yet that because a mortgagee does not immediately pounce upon his security, foreclose, take possession, and sell, that he impairs the obligation of his lien."

The Atlantic, Mississippi & Ohio Case (3 Hughes, 340).

In the case of *Coe* vs. *New Jersey Midland Ry. Co.* (31 N. J. Eq., 105), the highest Court of New Jersey reviewed these questions. An attempt was made to prefer labor claims over the mortgage debt, it being asserted that the services of the laborers were of great value in preserving the mortgage security, etc., and it being made to appear that after default in payment of interest, the mortgage trustee allowed the mortgagor company to continue in possession and operate the road, instead of taking possession, as he might have done under the mortgage. The Court held that the fact that the employees were not aware when they rendered their services that default had taken place, gave them no claim against the mortgagees for their wages, notwithstanding an Act of the Legislature which provided that whenever the Chancellor should appoint a Receiver of any railroad, the Receiver should apply all incumbered personal effects and all moneys which might be transferred to him at the time of assuming his duties to the payment of wages then due to employees of the company for not over two months back. The Court said that the lien which this act gave could not be extended so as to impair the obligation of lien of duly recorded incumbrances antecedent to the act. The *Galveston R. R.* case was cited in support, and *Fosdick* vs. *Schall*, was distinguished. The Court further says:

"The mortgagees owed to the employees of the mortgagor no duty under the circumstances; they were at liberty to refrain from taking possession if

and as they saw fit, and by so doing they incurred no liability to the employees of the mortgagor to indemnify them on the contracts, express or implied, of the latter with them for the payment of their wages. The mortgages were on record, and the record was notice to all. It surely would not be claimed that the holder of a mortgage past due upon a farm is liable, merely because he is a mortgagee, for the wages of the hands employed by the mortgagor in working the farm after default, * * * although it may have been of the greatest importance to the mortgagee's security that the farm * * * should not go untilled. It is due to the proper administration of justice that the rights of all parties shall be clearly understood and strictly respected, and recourse is not to be had to devices, either by way of refinement in the application of principles or the introduction of new doctrines to effect purposes which, however commendable in their design, result in operation in taking the property of one man to pay another's debt, and in creating liens in favor of one class of creditors to overrule the existing lawful liens of others, which is neither according to law or equity, and is in violation of constitutional rights. * * * Such liens could not be confined to that class of meritorious creditors, but must be extended to all others with claims equally meritorious, though not for the wages of labor."

Even, then, had there been any delay after default such as is asserted by the appellants, and the appellants' claim had arisen *during* this delay (which is not the case), the above authorities show that no *agency* would have been created by that delay, that many other circumstances, would have had to be considered to create an estoppel against the mortgagee, and that, the appellants' claim not being an *operating* expense, no consent to its creation could have been implied against the mortgagee.

(2.) Whatever the argument to be

deduced from delay in taking possession, that argument is inapplicable here, where there has been no delay.

We have already on pages 3–4 of this brief stated the facts showing that the appellants' claim, declared by the master not to be in any sense a current operating expense, arose and matured, was extended voluntarily by the appellants, and, as so extended, again matured for the most part, before any default occurred on any of the Railroad Company's bonds, before the rights of any of the mortgagees to take possession sprang into existence, and before any *valid* receivership was created. Indeed, since even the receivership, created under the Southern Development Company's bill and afterwards declared void, only began on February 21st, 1885 (Rec., p. 106), these things had nearly all happened before the inception of that receivership. What justification, then, is there for all this talk of delay? If it were true, as appellants assert, that the trustee of the Waco and Northwestern Division mortgage slept on its rights from March, 1888, the date when its rights arose, to April, 1889, the date when its foreclosure bill was filed, how could that in any way improve the claim of appellants, whose lien, if they have any, necessarily matured *before* the beginning of the trustee's alleged supineness and at a time when it had no power to act, and, indeed, no knowledge of the situation? It must not be forgotten that at the time when the rails were delivered (February to May, 1884), and when, therefore, if ever, the appellants' lien must have arisen, the Houston and Texas Central Railway Company was a solvent, going concern, with the best of credit, as is shown by the fact that it could make such contracts as the three made with these very appel-

lants, and it was operating its various lines of railway, including the Waco and Northwestern Division, and paying its debts and obligations as they matured, including the notes and obligations given for the rails under the prior contracts as they matured from time to time. Moreover, there was no default in the payment of any mortgage interest.

This being the very excellent condition of affairs of the Houston and Texas Central, so far as the world knew and so far as its bondholders knew, in 1884, the bondholders had no right to make any inquiry as to the way in which the road was being run. They could not ask what contracts were being made for rails or for anything else. They were receiving what they were entitled to, and that was their interest, and they had no right to ask for anything else, and it was nearly a year after May, 1884, when the last rail was delivered, before the road went into the hands of Receivers, and it was two full years before the road passed into the hands of a Receiver legally and properly appointed.

But was the trustee supine even after its rights accrued, on March 1st, 1885? The receivership under the Southern Development Company's bill, begun on February 21st, 1885, fell like a thunderbolt out of a clear sky. The Farmers' Loan and Trust Company was not made a party to that bill. But on March 31st, 1885—*within 30 days after its right to act had matured*—that Trust Company filed its petition in the Southern Development Company's case, praying to be made a party for the protection of the several mortgages represented by it (Rec. p. 115). This petition was granted, and on June 15th of the same year the Trust Company filed its answer to the original bill and to a supplemental bill which had been filed in the meantime (Rec., p. 115). Presently, on May 27th, 1886, the Southern Development Company's bill

was dismissed and the receivership thereunder discharged, a new receivership being simultaneously created in a new cause, known as consolidated cause No. 198, in which the trustees of the main line mortgages *and the appellee*, as trustee of several mortgages, including the Waco Division mortgage, were named as complainants (Rec., pp. 108, 166). In this cause, the appellee filed an answer to the bill of the main line mortgagees, setting up its rights and praying for the payment by the Receivers of its overdue coupons (Rec., p. 117). The result was that on May 27th, 1887, an order was entered directing the Receivers to pay the two coupons on the Waco and Northwestern Division mortgage which fell due in January and July, 1885 (Rec., p. 117), and those coupons, with interest, amounting altogether to $91,371, were accordingly paid (Rec., pp. 114, 117). The appellee also filed petitions for the payment of subsequent coupons but no orders were entered on those petitions (Rec., p. 117) and finally it filed its bill to foreclose the Waco and Northwestern Division mortgage in April, 1889.

How, under these circumstances, can it be said that the appellee was dilatory in protecting its interests? The property came into the hands of the Court before the appellee's right to act matured; within a month of that right's maturing, appellee moved the Court to admit it as a party to protect its interests; it knew that the property was safe in the hands of the Court under one receivership or another without a break until it should file its own foreclosure bill; it was at all times before the Court presenting its views as to the administration of the property and seeking, and sometimes obtaining, payments on account of its debt; and it knew that by filing its own foreclosure bill during the pendency of the prior bills no additional pro-

tection would be gained to that which existed already. To say that it was neglectful of its rights under such conditions is simply to fly in the face of facts.

(3.) The appellants have no lien upon either the earnings or the corpus.

In the first place, the appellants claim (Brief, p. 20) that when the contract was made with the Houston and Texas Central Railway Company, by which they sold, and the Railway Company bought, certain rails, a *lien* was created upon the income and the *corpus* of the property superior to that of the mortgage creditors.

Lest we should misapprehend their position, they again, on page 48, state their claim that the furnishing of the rails created a lien in favor of the Lackawanna Company against the Railway Company and its property and the income thereof, and that such lien is superior to the mortgage, upon the ground that the mortgage creditors impliedly authorized the Railway to create such a lien and have received the benefit of the rails.

Now, we have already pointed out the futility of that claim. But there are still other reasons which show the incorrectness of the appellants' position.

This *lien* which they are supposed to have created upon the Waco and Northwestern Division of the Houston and Texas Central was a lien upon a Texas railroad, with all its property in the State of Texas, forming a division of a great railway, the Houston and Texas Central, not one foot of which was outside of the State of Texas. Surely, if any contractors were ever amenable to Texas law, it would be those who were endeavoring to create and who did create, if the appellants are correct, a lien upon

Texas real estate, owned by a Texas corporation. If these parties had been making a written indenture of mortgage, no possible question could arise but that they were subject in respect to such mortgage to Texas law, and whether counsel call the lien, which they claim to have created, a legal lien or an equitable lien, or any other kind of a lien, it must, if a lien at all, be governed by Texas law.

Now, unfortunately for this entire lien doctrine, the statutes of Texas are peremptory on the subject.

The Act of 1876, as given in Sayles' Texas Civil Statutes and referring to railroad corporations, prescribes as follows:

"Art. 4220. No mortgage by such corporation shall be valid unless authorized by a resolution adopted by a vote of two-thirds of all the stock of such company, after notice and in the manner provided in this title for increasing the capital stock of such corporation.

"Art. 4221. When any such resolution has been adopted, in the manner provided in the preceding article, it shall be recorded in the office of the Secretary of State, and no such resolution shall take effect until so recorded."

If the appellants had any right to a lien under the statutes of Texas, they should have complied with those statutes. Failing to do so, they cannot escape from the consequence of their failure by claiming an equitable lien under the authority of *Fosdick* vs. *Schall*.

Farmers' Loan and Trust Co. vs. *Chandler* (18 S. E., 540).

But counsel will probably say that, after all, we are playing with words; that he quite agrees with the Courts which have so frequently stated in these railroad cases that the equity which they allow is

not a lien, but, as Judge Drummond said in the 8th Bissell, 315, that in point of fact the allowance of these "back-claims" cannot be justly called a lien, but an exercise of equitable power in the premises. If this be so and if counsel takes that position, then surely the appellants had no *lien* when they advanced the rails, and the contention is not true (Brief, p. 45) that *the furnishing of the rails* created a *lien*. If there was no *lien*, then the appellants must take their position as ordinary intervening creditors, claiming on certain equitable grounds, a right to prior payment out of the property in the hands of the Court. We think that we have already shown that they have no such claim in equity. Counsel will find it very difficult to bring forward even a case of a private individual's mortgage where a party has been allowed to establish a lien by his labor or material furnished upon a piece of property when the mortgagee was ignorant of the fact that such labor or material had been furnished. In the present case the holders of these bonds and their trustee knew nothing about the fact that this railroad needed new rails, or that the Lackawanna Company had furnished those rails on credit. All they knew was that the interest was being promptly paid, and that the Railway Company was fulfilling all its obligations to those from whom it had borrowed money.

(4.) The Appellee's mortgage extended to and covered income.

On page 76 of their brief, the appellants assert that the Waco and Northwestern Division mortgage did not cover income. The mortgage shows the contrary. In the form of bond set forth in the mortgage (Rec., p. 13), and in the description of the property in the conveying clause (Rec., p. 14),

the language is clearly broad enough to include income. And the language of the provisions of the mortgage as to the trustees taking possession (Rec., p. 15) expressly mentions income and shows conclusively that it was the intention of the parties to mortgage the incomes.

But the appellants, seeking by an illogical argument, to sustain their *own* lien on the earnings by proving *ours* to be bad, say that whether income is covered or not, the trustee acquired no claim to it because it never demanded possession of the railroad company. And they cite the familiar cases establishing the doctrine that only the beneficial income is covered by such mortgages and that, before the income can be applied to the use of the mortgagee, it must be sequestered. But those cases did not require, as appellant seems to suppose, the institution of a foreclosure suit, or the actual taking possession by the trustee. Of what use would it have been to demand possession of the railroad company which had no possession after February, 1885, at which time the Court itself took possession of the road and sequestered its income under a general creditor's bill. We have already pointed out that as early as March, 1885, the appellee intervened and set up its claims against the property, and, without again going over the facts, we think it clear that from that time on the appellee kept its claims as mortgagee actively before the Court without interruption.

New York, March, 1899.

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